98TH CONGRESS
1st Session

SENATE

REPORT
No. 98-15

THE 1983
JOINT ECONOMIC REPORT

REPORT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ON THE

FEBRUARY 1983 ECONOMIC REPORT OF THE PRESIDENT

TOGETHER WITH

ADDITIONAL VIEWS

MARCH 3 (legislative day, FEBRUARY 23), 1983.—Ordered to be printed

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98TH CONGRESS
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REPORT
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REPORT ON THE FEBRUARY 1983 ECONOMIC REPORT OF THE PRESIDENT

MARCH 3 (legislative day, FEBRUARY 23), 1983.—Ordered to be printed

Mr. JEPSEN, from the Joint Economic Committee,
submitted the following

REPORT

together with

ADDITIONAL VIEWS

[Pursuant to sec. 11(b)(3) of Public Law 304 (79th Cong.), as amended]

This report is submitted in accordance with the requirement of the Employment Act of 1946 that the Joint Economic Committee file a report each year with the Senate and the House of Representatives containing its findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report. This report is to serve as a guide to the several committees of Congress dealing with legislation relating to economic issues.

CHAIRMAN'S INTRODUCTION

Roger W. Jepsen, USS

This Report of the Joint Economic Committee is released in an atmosphere of growing optimism about the economy. For the past two months, the economic statistics have pointed in one direction—recovery. More importantly, the broad and strong advance of economic indicators provides evidence that the recovery will be stronger than anticipated.

In this Report, we look at America's future and recommend policies that will provide a long and continuous recovery. Such a recovery is the only way to permanently attack our serious unemployment problem. Policies that are good for the short run but jeopardize the recovery must be rejected. The "quick fix" is the worst of all possible solutions. Concerning unemployment, Congress will soon pass legislation providing assistance to the unemployed. However, no government training and employment program will be successful unless there is a recovery. Therefore, we must overcome the barriers to a durable recovery. We must remember that the most powerful government weapon is to reduce structural unemployment, or unemployment caused by a lack of labor skills. This Report recommends that the hard-core unemployed be provided employment and training in the private sector through government incentives to business.

First and foremost, we must attact the large deficits that cloud our future. This Report is adamant that the deficit must be attacked primarily on the spending side and lastly on the tax side. We believe that entitlements programs and defense spending as well as all other areas of the budget must be scrutinized or reductions in the rate of expenditure increase.

Tax increases must not be the scapegoat for deficit reduction. The last Administration tried to balance the budget by increasing taxes—in fact, doubling taxes in only four years—and the result was the beginning of the three years of no real economic growth. Some tax increases may be necessary but only as a last resort; only when we have gotten control of spending.

Inronically, one of the major causes of our current deficit has been the welcome, rapid decline in inflation. As inflation has declined to only about a third of what it was when Ronald Reagan took office, government has been justly denied the revenues derived from inflation pushing taxpayers into higher and higher tax brackets. This is not to argue that we should use inflation to balance our budget, as I fear some are quietly advocating. If we return again, have excessive monetary growth, we will again have surging inflation. And it must be noted that this higher rate of inflation will not cause real economic growth to occur, but will in fact lead to another recession. Inflation in not our ally; it is our most debilitating enemy.

The Federal Reserve in the past two years has, at crucial times, severely restricted the growth of the money supply. I believe that this caused the recession in 1981, and prolonged it in 1982. I hope that the Federal Reserve will be more accommodative in the early stages of this recovery. But the Fed should be warned that efforts to "print" our way out of our economic problems will not be tolerated.

The economic slump of the United States has been matched by economic slump around the world. It is unfortunate that many foreign governments have sought to protect their economies by creating barriers to imports which subsidizing their exports. The United States should assure all foreign countries that will not allow their barriers against ours and all other products to stand. The world economy in 1982 was also marked by an international debt crisis. The Administration has moved forcefully to provide funds to the International Monetary Fund to provide insurance that the crisis will not lead to worldwide economic disruption. I support the Administration's IMF proposal.

Finally, I represent a state that has a wide range of agricultural interests. It is not unusual, therefore, that I should attempt to champion the cause of America's farmers. But I suggest that anyone—whether they be Republican or Democrat, conservative or liberal, rural or urban dweller—should be horrified at the economic condition of the American farmer. The American farmer, the most productive worker in the world, has been victimized by his own success. His ability to cheaply produce mass quantities of food, and his willingness to share his technical expertise with the less fortunate on this planet, have helped to drive down the prices of his products and reduce his profits to Depression levels.

The problems of the American farmer did not begin a year or two or five years ago. And, just as importantly, the economic misery of the American farmer will not end with the beginning of this recovery. But if must not be viewed as a final step. We must begin a wide-ranging debate on how to improve the agricultural sector of our economy. Failure to do so will lead to economic and human suffering faster than any other failure. That debate must start and it must start now.

These are the policy recommendations that I believe will give us a better economy and stronger society. The economic condition of the economy is growing stronger and the nation can once again look at the future with confidence. Let us all hope that this recovery will have the chance to provide a better life for all Americans.

I want to thank the Republicam Members of this Committee for their hard work in writing this Report. We Republicans have conducted our negotiations with vigor but have always maintained our personal honor. I am proud to occupy the chair of a committee with these honorable men and women as Republican Members.

VICE CHAIRMAN'S INTRODUCTION

LEE H. HAMILTON, M.C.

The Democrats' report on the state of the economy is notable for two reasons. It faces up to the major issues before Congress, including monetary policy, jobs, taxes, defense, entitlements, and the International Monetary Fund. Also, it is a unified report which, given the diversity of Democrats on the committee, reflects a growing consensus on economic policy among Democrats in Congress.

We must have strong and sustained economic growth. That is our basic message and our basic goal.

For the shorter term, the Federal Reserve should set monetary policy to achieve low real interest rates this year. We are not persuaded that the Federal Reserve cannot control interest rates because we have seen that the easing of money since last summer has brought about lower interest rates.

Other steps need to be taken to get the economy growing this year. Because the growth must be based on principles of fairness, Congress should enact a significant jobs program, provide additional support to low-income people, extend the federal unemployment compensation program, give fiscal assistance to state and local governments, and place a cap on this year's scheduled income tax cut.

For the longer term, we propose a vigorous deficit-reduction program whose fundamental aim is to keep the economy growing. Personal income tax indexing should be repealed. Inefficient and regressive tax expenditures should be eliminated. There should be no broad-based tax on consumption.

To keep economic growth from being choked off by excessive spending, increases in the military budget should be slowed and entitlement programs must be reviewed for ways to reduce budget deficits. Both these categories of federal spending merit scrutiny.

Economic growth can be sustained only if inflation is held in check, if productivity increases, and if the productive capacities of people are used.

Relief from inflation last year was principally due to the recession. Placing such a heavy burden on one segment of the population was unnecessary and unfair. A better way to hold down the wage-price spiral would be to forge a consensus anti-inflation policy based on the cooperation of business, labor, and government.

The federal government should look to boost productivity and open up opportunities for productive work by strengthening job training programs, improving education at all levels, providing more support for civilian research and development, and modernizing public infrastructure.

Finally, the federal government must fulfill its international responsibilities. This means ending the overvaluation of the dollar and seeking proper enforcement of trade laws while insisting on the elimination of barriers to our exports.

The requested increase in the lending authority of the International Monetary Fund should be approved. That action should be accompanied by a tightening of oversight of foreign lending.

We must come to understand that economic growth depends more than ever before on events taking place beyond our shores.

In sum, the Democrats on the committee are united behind a program that is sensible, comprehensive, and workable. It emphasizes economic growth. What it envisions is realistic and what it asks is fair.

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I. REVIEW AND OUTLOOK

Recommendation

The present economic recovery will be stronger than the Administration currently forecasts. Economic policy in 1983 should focus on prolonging the recovery.

The economic recovery has begun. This is a welcome development, but like all recoveries it is surrounded by many questions. Foremost is: Will this recovery be strong enough to lift the economy out of the doldrums it has been in since 1979? There are no more telling statistics concerning our economic problems than that the country has had no real economic growth since the fourth quarter of 1979 and that unemployment has been rising for over three years.

The greatest threat to this recovery would be to direct future economic policy at the past recession. Efforts by the Federal Government to "spend" our way to recovery or efforts by the Federal Reserve to "print" our way to economic health after this recovery has already begun will only sow the seeds of our next recession. We would be committing the same errors that have caused this decade-long decline in our economic fortunes. Instead of looking back, economic policy should focus on ways to sustain the present recovery.

The present expansion seems to be developing along traditional lines, in that it is being led by recoveries of the housing and the auto industries. Housing starts in January, 1983 of 1.7 million units (annual rate) were almost double what they were in June 1982 and 36 percent above December. Housing permits, which provide an indication of future housing activity, increased to an annual level of 1.5 million units in January which is 16 percent above December and almost double the annual rate of last August.

The automobile industry began a strong surge in late 1982. The seasonally adjusted industrial production index for autos rose 25 percent from November 1982 to January 1983. Domestic auto sales have also turned around. From December through the first ten days of February, they have averaged 6.1 million, seasonally adjusted annual rate, compared to 5.8 million for the year 1982 as a whole. Most importantly, rising auto sales have resulted in "call backs" of laid-off workers at some auto plants.

The housing and auto expansions are a direct result of falling interest rates. The prime interest rate which peaked at 21.5 percent in December 1980, and was as high as 16.5 percent last summer, is presently at 10.5 percent. More importantly, market interest rates have fallen almost as dramatically. The 90-day Treasury bill rate was 13.65 percent a year ago, it is now 8.01 percent. Long-term interest rates have also fallen. The rate on 30-year Treasury bonds has fallen from over 14 percent last February to under 11 percent this month.

Other recent economic signs that the recession is over are the 4.5 percent increase in durable orders in January; the 0.9 percent increase in industrial production in January, the second rise in a row following declines in nine of the ten previous months; and a 1.5 percent rise in the index of leading indicators in December, the eighth rise in the last nine months.

Perhaps the measures most often used by the public to determine the economic health of the country are inflation and unemployment. In fact, President Carter even popularized a term known as the "misery index," which consisted of the inflation rate plus the unemployment rate. In the case of inflation, the increase in the Consumer Price Index of 3.9 percent for 1982 was the smallest increase in the indicator since 1972. In fact, an actual reduction in the price level itself occurred in a recent month. Other measures of inflation showed similar remarkable progress. The increase in the prices for finished goods of producers was 3.5 percent in 1982, one-half their rise in 1981 and less than a third of their rise in 1980. The gross national product implicit price deflator increased by 6 percent in 1982, compared with 9.4 percent in 1981.

The disastrous unemployment problem in this country shows some signs of turning around. The civilian unemployment rate in January fell to 10.4 percent from 10.8 percent in December. Though some of this decline is the result of an inaccurate seasonal adjustment process, the January figures do show significant improvement in the employment picture. Initial claims for unemployment insurance have declined by 200,000 from their peak in early September. The defusion index, which measures the percentage of firms increasing employment, passed the critically significant 50 percent mark last month. The average workweek also increased, signaling that production has started to increase. Employment increased in the sensitive construction and retail trade sectors and payroll employment increased by 340,000 in January, after seasonal adjustment.

Our economic problems cannot be ignored because a recovery has begun. The absence of economic growth over the past three years has significantly worsened unemployment. While Congress should enact short-term programs to help the unemployed, these programs should be viewed as temporary assistance and not as substitutes for productive jobs. Only if this recovery is long and robust will a real solution to unemployment be found.

For the present recovery, the Administration forecasts real GNP growth in 1983 of 3.1 percent (4th quarter over 4th quarter). Compared to most private forecasters, this is a very pessimistic outlook. Blue Chip Indicators, which surveys 45 blue chip companies for their economic forecasts, puts the growth rate for 1983 at approximately 4.5 percent. All but two of the 45 economic forecasts have more optimistic estimates for growth in 1983 than the Administration. More importantly, as signs of the recovery become increasingly clear, most private forecasters have changed their estimates to show even faster real economic growth in 1983.

The Administration is not unmoved by such "outside" advice. Martin Feldstein, the Chairman of the Council of Economic Advisers, testified before the Joint Economic Committee that he would not be surprised if real economic growth in 1983 reached 5 percent.

The reason for the discrepancy between Dr. Feldstein's "official" forecast and his "unofficial" forecast was that the official forecast was made early in January while his testimony was given in February. No one can be sure of the precise date that recovery began. In early January it was not as clear as it is now that the bottom of the business cycle was in December. The earlier the recovery begins, the more economic growth when comparing 1983 to 1982. Virtually all forecasters are projecting a recovery far stronger than anticipated just a few months ago.

The Republican Members of the Joint Economic Committee join those who believe that the economy will perform better in 1983 and 1984 than the Administration currently forecasts. We hope to focus attention on the need to make our economic performance better in 1985, 1986 and beyond. Consequently, we must not take any steps that will jeopardize the future of this recovery. We advise against resorting to unnecessary tax increases in an effort to stimulate economic growth. In this regard, we believe that the third year tax cut and indexation should be preserved.

In setting forth our economic policy agenda, we should remember that our economic difficulties did not begin, and will not end, with the recent recession. We must set out sights on making the future better, rather than trying to correct the past. To meet our challenges we offer the following recommendations and report.

II. EMPLOYMENT POLICY

Recommendation

For the long run, the Congress and the Administration should direct their efforts to designing a job training program to reduce structural unemployment. These programs should emphasize the training of the hard-core unemployed by broad use of the private sector.

Progress against inflation in recent years has had a harsh, and probably unavoidable impact on the Nation's working population. The unemployment rate rose persistently month by month over the past several years as the Nation's economy receded. By December of 1982, the size of the unemployed labor pool swelled to 12 million, or 10.8 percent of the Nation's labor force.

The December unemployment rate was the highest level since the Great Depression of the 1930's, but it also signalled a turning point in the economy. The unemployment rate droped to 10.2 percent by January 1983. The Republican Members believe that this drop although small, provides a strong signal that the economy has turned the corner and is on the rebound. Though the unemployment rate may move up slightly from the 10.2 percent in coming months. Most experts believe that it will not again reach its December high. The sharp rise in January factory hours and the broad-based advance in the Bureau of Labor Statistics diffusion index of employment change are other important labor market indicators that signal an upturn in labor markets. The drop in unemployment benefit claims for newly unemployed workers in February provides additional collaborating evidence.

The impact of unemployment varies unevenly among demographic groups. Blacks experienced a 19.0 percent unemployment rate in January 1983 in comparison with a 9.1 percent for their white counterparts. The unemployment rate for women who maintain families was 13.2 percent. Age also makes a difference. Over 22 percent of workers in the 16 to 19 age group were unemployed, in comparison with an unemployment rate of 9.6 percent for men and 9.0 percent for women over age 20. The near doubling of the unemployment rate for men over age 20 since 1977 reflects important structural changes in the Nation's economy. Unemployment for the first time is reaching deeply into the ranks of the blue collar workers in the basic goods industries such as automobiles, steel and rubber.

Regional variations in labor market impacts are also prevalent. States in the manufacturing belt such as Michigan, Ohio, Indiana, Illinois, Wisconsin, and Pennsylvania all had unemployment rates well above the national average. Sunbelt and Western states such as South Carolina, Alabama, California, Mississippi, Washington, Nevada, and Oregon, also had unemployment rates well above the national average. On the positive side, 31 states had unemployment rates below the national average in 1982. The states with the lowest unemployment rates included Texas, Connecticut, Kansas, Massachusetts, Vermont, Oklahoma, South Dakota, and Hawaii.

We believe that the Nation's employment outlook is encouraging and will be reflected in a sizable reduction in the Nation's unemployment rate as the recovery gains additional momentum. The decline in the unemployment rate typically follows an upturn in GNP by two or three quarters (Table 1). Assuming the first quarter of 1983 marks the turning point in the recovery, which we believe it does, it will be mid- to late 1983 before we see a significant decline in the unemployment rate. Over the next few months, the unemployment rate may edge up slightly as a result of statistical aberations, but the trend should be clearly downward.

TABLE II.1.—THE LAG BETWEEN THE UPTURN IN THE BUSINESS CYCLE AND THE DECLINE IN UNEMPLOYMENT OVER THE LAST FOUR BUSINESS CYCLES

Quarter of upturn in GNP	Quarter of downturn in unemployment	Lag between GNP and unemployment movement
61–II	61–IV	2
70–II[1]	72–I	7
75–II	76–I	3
80–IV	81–III	3

[1] Beginning with second quarter 1970, GNP turned upward for two quarters, downward in fourth quarter 1970 and then steadily upward until first quarter 1974. If the cycle upturn is dated from first quarter 1971 the lag in the turn of the unemployment rate is four quarters, giving an average for the four cycles of three quarters.

The rate of decline in the unemployment rate beyond 1983 will depend upon the speed of the recovery. The modest recovery foreseen by the Reagan Administration will result in a projected unemployment rate of 8.9 percent in 1985 and 6.5 percent in 1988. The more robust recovery that we foresee will create jobs at a much faster pace. A drop in the unemployment rate to approximately 8 percent by 1985 is clearly possible.

The Republican Members firmly believe that economic recovery and an expansion in the Nation's productive capacity is the best jobs policy for the unemployed in the long run. As Richard Lesher, President of the United States Chamber of Commerce, recently put it, "Last month alone, the economic recovery increased jobs by 339,000. How many billions of tax dollars would it take to legislate jobs at that rate? And at what cost to the economy?

However, because of the shifts in the structure of the nation's economy, many workers find that their labor skills are no longer significantly demanded in the labor market. These structurally unemployed workers will not find satisfactory employment in the near future, even if the recovery is strong. To aid their retraining and employment prospects, Congress and the Administration should establish programs that hasten their return as a productive member of the labor force.

To understand why Federal efforts should aim at retraining, the causes of unemployment must be put into clear focus. Economists have identified three sources of unemployment: cyclical, frictional and structural. Cyclical unemployment, which accounts for about one-third of the current unemployment, occurs when the economy is in a slump and vanishes when the economy rebounds. The best employment policy for workers affected by cyclical unemployment is an economic recovery. Frictional unemployment occurs as a result of the approximately four million workers who change jobs or enter and leave the labor market each month. These workers are voluntarily unemployed in that they willingly forgo current employment to search for better paying, and/or more challenging jobs. Economic recovery cannot reduce frictional unemployment, and may even increase it as more workers attempt to use the mobility route to upgrade their employment status.

The third category, the structurally unemployed category, consists of individuals who are willing to work at the prevailing wage but they lack the necessary skills and experience to find a job. Women, youth, and minorities make up a disproportionately large share of the structurally unemployed, but it also includes many blue collar workers who will not be reemployed as the economy recovers because their former jobs have been permanently eliminated. These displaced workers are entering the ranks of the structurally unemployed at a much higher rate than in the past. They are a "fallout" from shifts in the Nation's industrial structure to a more service and high tech orientation. The best alternative for workers in the structurally unemployed class is to acquire the necessary skills to compete for jobs in new industries. Unfortunately, these workers may not be able to acquire new skills easily on their own. It is in this regard that government efforts can have their greatest employment impact. Some suggest that minimum wage laws provide a barrier for the structurally unemployed youth who would work at lower wages although the jobs are unavailable because employers will not hire youth at the minimum wage rate. For other workers, including the displaced workers, job training geared to the expanding service and high tech sectors provides a promising alternative to upgrade economic status and find alternative employment.

Job creation efforts, both in the public and private sector, must take into account the special employment of women. The different family responsibilities and employment needs of women should be recognized, and provisions for the development of alternative work schedules should be encouraged. Retraining programs should include an effort to promote employment of women in non-traditional occupations.

Strong efforts should be made to address wage and job discrimination toward women.

The economic recovery cannot be expected to restore full employment without creating excessive inflationary pressures unless the Nation's productive capacity is expanded. The dynamics of job creation explain why. During recovery, employment expands as idle capacity is diminished, and furloughed workers are reemployed. However, as stated, many former employees in the basic goods industries and others will find their old jobs eliminated. New jobs must be created for the displaced workers, the new entrants into the labor market and those structurally unemployed workers who lower their reservation wage or upgrade their skills. The new jobs will occur in the private sector as the Nation's productive capacity expands, but for productive capacity to expand, real investment in existing businesses and in new business starts must increase. The Republican Members maintain that higher rates of real investment and business formation are critical to a public policy to restore full employment in the labor market without rekindling inflationary pressures.

Job training assistance to promote the upward mobility of the semi-skilled and unskilled workers, the structurally unemployed, and the economically disadvantaged workers has much merit. The emergence of the information economy offers a bright future for America, but the transition is painful and filled with much uncertainty and a sense of hopelessness for millions of Americans. Industries like computers, research, semiconductors, telecommunications, robotics, biotechnology, chemicals, and aerospace will create millions of new jobs over the coming decades. Many of the new jobs will be within the high tech-oriented sectors but a larger number will be in the traditional sectors of the economy. Many businesses in the finance, insurance, manufacturing, medical, services, wholesale and retail, and other industries are regaining a competitive edge in the world marketplace by adopting the new advanced process technologies. The new wave of technologies is creating temporary labor market distortions but at the same time it is a major source of new job growth for the economy.

The labor market implications of the computer-based information age that we are just entering are not fully understood, but it is clear that the nature of work and the workplace is changing. A public policy to retrain displaced workers and facilitate the upward mobility of other workers caught in dead-end jobs can do much to facilitate labor market adjustments and mitigate the adverse impacts associated with economic change.

III. Fiscal Policy

Recommendation

Persistent Federal deficits must be reduced. Strict review of Federal expenditures is necessary. We reject proposals to reduce deficits by raising taxes that could cut short the recovery.

Prospects of $200 billion-plus Federal deficits, representing 5 to 6 percent of GNP over the next few years, are taking the U.S. economy into uncharted waters. Most financial analysts, the Congress, and the Administration are frightened by the risks such unprecedented deficits pose—crowding out in private credit markets, inflation, and high interest rates. We share the public concern over huge deficits. We recognize the importance of deficit reduction, but we caution against making deficit reduction the sole aim of economic policy. The first goal of policy must be sustaining non-inflationary economic growth. We believe that such growth will, in large part, help deal with the deficit problem.

In the first place, budget projections are, at best, tenuous, and major policy decisions based on outyear projections must be made cautiously. Deficits are among the most difficult of all economic measures to forecast. They are dependent on and are a composite of, numerous economic and political variables: inflation, unemployment, interest rates, GNP, government spending patterns and procedures, acts, of nature and a host of other things which themselves are hard to predict. Thus, outyear budget estimates should be recognized for their inherent weaknesses.

The following table shows the projected budget deficit (or surplus) in the Budget Messages of the Presidents for the years indicated, and the actual deficit (or surplus) for those years:

TABLE III.1.—PROJECTING THE DEFICIT

[Administration budget messages for years indicated versus actual budget results; in billions of dollars]

Year	Projected deficit (−) or surplus (+)	Actual deficit (−) or surplus (+)
1983	−91.5	−[1]207.7
1982	−45.0	−110.6
1981	−15.8	−57.9
1980	−29.0	−59.6
1979	−60.6	−27.7
1978	−57.7	−48.8
1977	−43.0	−44.9
1976	−51.9	−66.4
1975	−9.4	−45.2
1974	−12.7	−4.7
1973	−38.8	−14.8
1972	−11.6	−23.4
1971	+1.3	−23.0
1970	+5.8	−2.8
1969	−8.0	+3.2

TABLE III.1.—PROJECTING THE DEFICIT—Continued

[Administration budget messages for years indicated versus actual budget results; in billions of dollars]

Year	Projected deficit (−) or surplus (+)	Actual deficit (−) or surplus (+)
1968	−2.1	−25.2
1967	−1.8	−8.7
1966	−5.3	−3.8
1965	−4.9	−1.6
1964	−11.9	−5.9

Estimate.

Source: Congressional Quarterly and Office of Management and Budget.

Recent deficit estimates have been far off the mark on the low side. We believe that current estimates of future deficits may be as far off on the high side.

Our basic message is that deficits should not drive economic policy, but economic policy should drive out the deficits. Reasoned economic policy aimed at solid long-run economic growth should be the aim, with deficit reduction an important object of that policy, but not its only object.

We are very concerned about the prospect of mammoth deficits. We believe they should be reduced and ultimately eliminated by persistent expenditure control and by policies to promote economic growth. We reject proposals for major tax increases since, as in the past, this would accelerate growth in government and reduce private economic growth.

The upward tilt in Federal deficits has been many years in the making, growing out of demand-oriented economic policy, in which the government has been called on to solve one problem after another by creating new programs or by providing new injections of funds into existing programs. Elimination of such deficits will take many years. To try to do it all at once could be a jolt to the economic system. The important signal to the financial markets is that we are pointed in the right direction and the policies are in place or being adopted to reduce the deficits in 1984 and afterwards. The actual direction is more important than the speed at which deficits are reduced.

In approaching spending reductions we must discard the notion of "uncontrollable" budget items. As generally defined, "uncontrollables" include open-ended programs such as Social Security and railroad retirement, Federal employees retirement and insurance, unemployment assistance, medical care, assistance to students, food and nutrition assistance, and public assistance; net interest; general revenue sharing and farm price supports (CCC). These relatively uncontrollable items in the budget presently account for nearly 60 percent of the Federal budget. If outlays from prior-year contracts and obligations are included, the ratio of relatively uncontrollable outlays rises to over 75 percent.

We believe the concept of uncontrollable budget items should be abolished, except in the case of interest on the debt. Even interest costs can be controlled to a modest degree by sound policies to reduce interest rates. The entire budget deserves continual Congressional examination.

Since it would require a 100 percent elimination of the relatively controllable budget items (making up 25 percent of the budget) to eliminate the budget deficits (e.g. $204 billion in "controllable" national defense and civilian expenditures out of total budget expenditures of $848 billion in Fiscal Year 1984), it is clear we will have to turn to the big ticket items to accomplish the task—entitlements.

The Social Security program is a pay-as-you-go program, which affects the overall Federal budget. To think of Social Security as a trust fund operation, separate and apart from the overall Federal budget, really has no meaning. Every Social Security tax dollar is a Federal budget revenue dollar, and every Social Security benefit payment is a Federal budget outlay; it involves substantial sums of revenues and outlays and is getting bigger all the time. Even if we still had a large Social Security Trust Fund surplus, which we do not, the money coming in is not as great as the money going out and the impact on the budget and on the economy is very real and very direct.

The rate of rise in Social Security benefits should be reviewed. We suggest the review of long-term payments and do not propose cuts in benefits. The National Commission on Social Security Reform (NCSSR) has reported out a package of proposal to cope with the rising gap in Social Security outlays and revenues. The entire package deserves fair consideration by the Congress. Several of the Commission recommendations would have major impacts on the trust funds, although impacts on the Federal budget deficits would be considerably less than on the trust funds, because about one-third of the $168 billion package represents either transfers from the general fund or amounts that would be offset by increases in spending for other Federal programs or by reduced tax revenues.

The NCSSR proposed that OASDI benefits be reduced by enactment of a permanent six-month delay in the annual cost-of-living adjustment. Thus the annual (COLA) payable in June (received in July) would be paid in December instead (received in January). The Congressional Budget Office estimates this would reduce OASDI payments by $24.1 billion over fiscal years 1983–1988, although this would be offset by $4.2 billion in payments to Supplemental Security Income recipients (welfare recipients) who would be allowed to retain $30 more in total benefits each month to offset the impact of the Social Security COLA delay.

The National Commission also recommended that, beginning in 1988, COLA adjustments be based on the lower of the CPI increase or the increase in wages, if the fund ratio (fund balance as a percentage of the fund outgo) is less than 20 percent. No estimates of the cost savings have been made, but suffice it to say the savings would be substantial.

The shift to the lower of wage indexing or the CPI indexing, effective in 1984, might be a good way to slow Social Security outlays without serious hardship to recipients. The reason why Social Security outlays have grown faster than revenues in the recent past is that prices have risen faster than wages and salaries since 1979 and Social Security benefits are adjusted by the CPI, while payroll tax revenues increase with the growth of the wage base. If benefit COLA's were put on a wage base adjustment, recipients would still receive increased benefits, although at a lesser rate, but the overall impact on the trust funds and the Federal budget would be very beneficial.

With regard to defense spending, we must remember that the U.S. defense posture vis-a-vis the Soviet Union has deteriorated over the past decade. No one seriously questions that. Also, national defense outlays as percent of GNP declined from 8.1 percent of GNP in 1970 to 5.3 percent in 1980. Not that any particular ratio is sacrosanct, but coupled with the continued Soviet build-up, these declining ratios mean that the U.S. military spending must rise relative to the GNP and relative to the total budget. However, the rise need not be as rapid as the Administration originally proposed. There is room for a scale-back or stretch-out in military spending increases. From a total of $215 billion in 1983, military spending will rise to $386 billion in 1988, and the ratio to total budget outlays will rise from 26.7 percent in 1983 to 34.2 percent in 1988. We make no specific recommendations regarding how or where to reduce defense spending, but candidates for curtailment would include limiting growth in operations and maintenance accounts, limiting growth in pay and benefits, imposing modest cuts in current force structure or build-up plans, and scaling back real growth in procurement accounts, by cancelling programs experiencing development problems or by redirecting preliminary development efforts to emphasize less expensive longer-term systems.

Lastly, we would like to reemphasize the point that economic growth is a potent reducer of deficits. Thus fiscal policy should be geared to private economic growth. This means tax incentives to promote savings and no tax increases. The reason Japan can live with deficit ratios of 5 percent of GNP is its very high savings ratio—20 percent personal savings ratio compared to our 6 percent. These high savings ratios enable Japan to finance private credit demands and still fund its deficit without putting upward pressures on inflation and interest rates.

The framework for the appropriate economic program to promote economic growth is in place. The Administration is correct in pursuing policies of reduced tax burdens, reduced spending, and reduced regulatory burdens. While the recession and high interest rates have been thorns impeding the short-run success of that program, its potential for long-run economic growth is sound.

To illustrate the power of economic growth in deficit reduction, the following table illustrates the dollar impact of a 1 percentage point increase in the rate of growth of real GNP on Federal revenues, outlays, and the deficit for Fiscal Years 1983 to 1987.

TABLE III.2.— EFFECT ON FEDERAL BUDGET PROJECTIONS OF CHANGES IN THE RATE OF GROWTH IN REAL GNP

[By fiscal year; in billions of dollars]

Effect of 1 percentage point increase in real GNP (Beginning January 1983)	1983	1984	1985	1986	1987
Change in revenues	+9	+23	+35	+45	+60
Change in outlays	−2	−5	−11	−17	−24
Change in deficit	−10	−28	−46	−62	−83

Note.—Totals may not add due to rounding.

Source: Congressional Budget Office.

If real GNP could grow 1 percentage point faster than projected over the next five years, the 1987 deficit would be $83 billion less. Though the relationships are not exactly linear, a 2 percentage point increase in real GNP would result in roughly a $166 billion reduction in the 1987 deficit.

IV. TAX POLICY

Recommendation

No major tax increases should be enacted. The third year of the tax cut and indexation should be preserved.

By the beginning of the 1980's it became increasingly apparent that many years of legislated and unlegislated tax increases had condemned the economy to low growth, high unemployment, and declining standards of living. Incentives for work, investment, and saving had been seriously eroded. American industry, over-taxed and starved of capital, was stagnating and losing its ability to compete in the world marketplace. Between 1976 and 1981, Federal revenues leapt from $298 billion to $599 billion, an increase of $300 billion or about 100 percent. As a percentage of GNP, Federal tax revenues increased from 18.2 percent to 20.9 percent, the highest level since 1944. Marginal and average individual income tax rates had risen substantially. The weighted average of marginal rates of all tax returns jumped from 27.8 percent in 1976 to 32.2 percent in 1981, mostly due to inflation-induced bracket creep. Fueled by the enormous growth of Federal taxes, Federal spending expanded at an even faster rate.

Popular resentment against runaway taxing and spending forced a major change in government fiscal policy. The Reagan Administration was given a mandate to reduce the heavy and growing tax burden in the United States. With the enactment of the Economic Recovery Tax Act of 1981 (ERTA), individual marginal tax rates were cut 23 percent across the board, a reduction mostly preserved by indexing of the tax brackets starting in 1985. Corporate depreciation schedules were liberalized to allow accelerated cost recovery for tax purposes. Though the reduction of individual taxes is modest even when fully in place, due to bracket creep and higher Social Security taxes, ERTA does stem the rising tide of revenue increases. Federal revenues as a percent of GNP is projected to decline to 18.3 percent by Fiscal Year 1988, still higher than they were in 1976. Furthermore, the indexing provision makes the tax reduction permanent and not merely temporary.

This preservation of the tax cuts is one of the major reasons indexing is important to the future economic growth of this country. Consequently, current proposals to increase the tax burden of the American people by repealing indexing could not be more ill-considered. The central purpose of tax indexing is to limit excessive and disproportionate growth in tax receipts due to inflation. Because of the progressive structure of the tax code, a 10 percent rate of price inflation is estimated to increase tax revenues by about 17 percent. Government profits from inflation through bracket creep, taxation of phantom profits to inflation. Because of the progressive structure of the tax code, a 10 percent rate of price inflation is estimated to increase tax revenues by about 17 percent. Government profits from inflation through bracket creep, taxation of phantom profits and capital gains, and decline of the real value of its debt. An unindexed tax code is undoubtedly one of the most convenient financing mechanisms available to the Federal Government. The only problem is that it's too convenient. Automatic tax increases provide plently of funds for desired spending expansion without the need for legislated tax increases. The Government can always find ways to spend all the revenue it collects, and then some. By limiting unlegislated tax hikes, indexing promotes fiscal responsibility and improves Congressional decision-making. Moreover, we believe, since major spending programs have been indexed to the inflation rate for many years, it is an essential act of fairness to treat those who pay for government spending as well as we treat those who receive such spending.

Indexing adjusts individual tax brackets, zero bracket amounts, and personal exemption for infation starting in 1985. However, little-known by the public is that the repeal of indexing would harm the poor and middle-income groups more than others. Without indexing, inflation would continue to push taxpayers into higher and higher brackets. This well-known phenomenon, "bracket creep," increases both the marginal and average tax rates of almost all taxpayers. But lower- and middle-income taxpayers are especially victimized by "taxflation." The fixed zero bracket amount and personal exemption come to a larger proportion of their gross income, and the tax brackets at the lower and middle levels are much more closely spaced than those near the top. The repeal of indexing would amount to an enormous regressive tax increase, falling heaviest on the working poor and middle class.

This effect of inflation on tax liability can be shown by a few simple comparisons. A family of four earning $15,000 in 1982 with annual cost of living adjustments would lose almost all of the tax benefits provided by the 1981 Economic Recovery Tax Act (ERTA) through bracket creep alone (using 1980 as a starting point). This family would receive $248 in tax relief from the rate reductions in 1983, but $214, or 86 percent would be wiped out by inflation-induced bracket creep. This leaves a meagre $34 in net tax reduction. In 1984, $271 of $334 tax cut, or 81 percent, would be consumed by bracket creep, allowing the taxpayer only $63 of his tax break under ERTA. Jumping ahead to 1987, through bracket creep this family would lose $489, or 86 percent of $567 from ERTA. In the following year, $566 (87 percent) of his $647 tax cut would be erased by inflation.

A repeal of indexing would allow this process to continue unchecked after 1985. This would amount to a sizable tax increase for this taxpayer. Without indexing in place in 1985, this family would pay $295 more in Federal income taxes in 1988, an increase of about 22 percent in their taxes.

Another family of four, starting with $25,000 in 1982, does a little better. In 1983 they lose $423, or 69 percent, out of their $609 tax cut to bracket creep, leaving them with the sum of $186. In 1984, $543 (67 percent) out of $808 slips away, leaving them with $265 of their tax relief. By 1987, $944 of their $1313, 76 percent, would be taken by inflation, leaving a balance of $369. In 1988 bracket creep robs them of $1167, 78 percent, of $1501 in tax benefits. If indexing were repealed, in 1988 this taxpayer would pay about $624 more than he would under current law, a tax increase of about 20 percent.

A family of four earning $40,000 in 1982 is also pinched by bracket creep. In 1983, this taxpayer would lose $1008 (76 percent) of his $1318 tax cut, in 1984, $1288 (74 percent) of $1739, in 1987, $2415 (81 percent) of $2961, and in 1988, $2848 (83 percent) of $6927. If indexing were repealed, in 1988 he would pay about $1560 more than under current law, a tax increase of about 22.5 percent.

Another way of looking at indexing would take into account the distribution of taxable income and the relative impact of indexing on each income class. According to the Joint Committee on Taxation, indexing would benefit the lower income taxpayers the most. The percentage of tax relief accruing to the various income classes would be greatest at the lowest class, and decline steadily as income rises. According to a Joint Committee on Taxation study, 1981 expanded revenue contributions under the current inflation rate by the various income classes would, in percentage terms, be 16 times greater at the bottom than at the top.[1] (See table IV.1.)

TABLE IV.1—TAX INCREASES FROM INFLATION: LESS [1] AGGREGATE TOTAL AND PERCENT OF INCOME TAX LIABILITY UNDER PRESENT LAW BY INCOME CLASS (1981 INCOME LEVEL)

Expanded income (thousands)	Aggregate total (millions)	Percent of income tax liability
Below $5	$168	([2])
$5 to $10	1,232	19.3
$10 to $15	1,365	8.4
$15 to $20	1,570	6.8
$20 to $30	3,703	6.3
$40 to $50	5,268	6.1
$50 to $100	2,781	5.4
$100 to $200	771	3.2
$200 and over	253	1.2
Total	$17,110	6.0

[1] Revenue gain from not adjusting personal exemption, earned income credit, zero bracket amount, and rate brackets by 9.14 percent.
[2] Individual income tax liability is negative for this group because earned income credits exceed tax.

In summary, an analysis of the relative impact of bracket creep on different income classes shows clearly that lower- and middle-income taxpayers would be hit very hard by repeal of indexing. Bracket creep takes a larger bite out of lower incomes than higher incomes. Furthermore, the very wealthy do not benefit much from indexing for the simple reason that additions to their income are already taxed at the top rate which is now fixed at 50 percent. These wealthy taxpayers are the only ones who do not gain greatly from indexing. Indexation is a reform which is eminently progressive in every sense of the word. Whether they realize it or not, advocates of indexing repeal are promoting a huge tax increase on everyone except the rich.

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[1] Background and Issues Relating to Individual Income Tax Reductions, Joint Committee on Taxation, April 1981, p. 12.

Support for the repeal of indexing is largely motivated by fears about large projected deficits. Although this is of serious concern, in this respect the repeal of indexing would be completely self-defeating. First of all, average higher marginal tax rates would impose an additional drag on saving, investment, economic growth, and employment. By shrinking the pool of savings available, higher marginal tax rates (from bracket creep), via repeal of indexing, would make financing the deficit more difficult, not less. In addition, more tax resources will stimulate an increased rate of government spending which, if past experience is any guide, might well exceed projected revenue growth and increase the combined on-budget and off-budget deficit. This is what happened at the end of the last decade with the $300 billion revenue increase between 1976 and 1981.

Another political danger of an unindexed tax code is the encouragement of inflationary biases in government. The temptation to inflate our way out of fiscal problems will likely become very strong in the years ahead. Tax indexation is a vital reform which lessens inflationary political pressures on the monetary authorities.

We fear that the primary objective of repeal of tax indexing is to provide a way to finance accelerated Federal spending. By repealing indexing, Congress could avoid making the hard choices necessary to restrain runaway Federal spending. This political reality is why we oppose any tampering with indexation, the third year of the tax cut, or enactment of any other major income tax increases.

Despite much discussion linking widening deficits with "excessive" revenue reductions, a quick look at the facts should dispel this myth. In Fiscal Year 1983, projected baseline revenues are $606 billion, and outlays $800 billion, leaving a deficit of $194 billion. Revenues are projected to increase $47 billion between Fiscal Year 1983 and Fiscal Year 1984, and then rise at least $50 billion each fiscal year after that. Nonetheless, deficits are projected to widen to $267 billion by 1988. With tax revenues rising over $50 billion annually after Fiscal Year 1984, it is impossible that they be the source of widening deficits—the answer must be that Federal spending is outpacing the rise in revenues through 1988. Table IV.2 shows that spending is increasing about $70 billion annually through Fiscal Year 1988. The cumulative effect of this rapid expansion of outlays is creating the problem.

TABLE IV.2.—BASELINE PROJECTIONS BY FISCAL YEAR

[In billions of dollars]

	1983 base	Projections				
		1984	1985	1986	1987	1988
Baseline revenues	606	653	715	768	822	878
Baseline outlays	800	850	929	999	1,072	1,145
Baseline deficit	194	197	214	231	250	267

In conclusion, we feel compelled to restate the fact that we cannot tax ourselves into prosperity. Imposing heavier tax burdens on our people will not help them or our economy. It's time to hold the line on major tax initiatives. The Congress should not repeal the third year of the tax cut and indexation.

V. MONETARY POLICY

Recommendation

We recommend that the Federal Reserve gradually decrease money growth to a range that is both consistant with normal long-term real GNP growth and low inflation. We warn against keeping money growth too fast, too long. That would produce another "calamity boom." With a lag of about two years, inflation will surge once more, making another recession inevitable.

From 1954 to 1964, measuring year over year, annual money growth (M1) averaged 1.9 percent. In the same period, real GNP growth averaged 3.6 percent a year, inflation (using the GNP deflator) averaged 2.0 percent a year, unemployment averaged 5.4 percent, and the Treasury bill rate averaged 2.8 percent and never exceeded 5.0 percent. In the next decade, increased Federal Government spending to finance the Vietnam War and a proliferation of so-called anti-poverty programs here at home placed continuing upward pressure on interest rates. The Federal Reserve, prompted first by President Johnson and later by President Nixon, tried to keep interest rates down by permitting the growth of M1 to accelerate to 5.6 percent a year in the 1965 to 1974 period. As a result, despite "jawboning" by President Johnson and controls under President Nixon, inflation increased and interest rates also rose. Inflation averaged 4.8 percent a year and the Treasury bill rate averaged 5.5 percent in the 1965 to 1974 period.

One of the lessons of the 1965 to 1974 period is that, if the Federal Reserve promotes rapid money growth, neither tax increases nor balancing the budget will keep inflation in check and interest rates down. That lesson was brought into clear view by the results of President Johnson's ill-conceived plan to "tighten" fiscal policy and "loosen" monetary policy in 1968. Acting on his proposal, in June 1968, Congress imposed surtaxes on personal and corporate income taxes, effective in January and April 1968, respectively, and the Federal Reserve permitted fast M1 growth by targetting interest rates, M1 increased by 7.0 percent in 1968. Consequently, inflation jumped, interest rates soared, our international trade balance deteriorated, and by the fall of 1969 the economy was in a recession.

Beginning in mid-1974 and continuing to the end of 1976, M1 growth was greatly moderated. The initial effect of slowing money growth was to exacerbate the 1974 to 1975 recession. But, in time, our economic performance greatly improved. Measured year over year, inflation dropped to 5.2 percent in 1976, from 8.7 percent in 1974 and 9.2 percent in 1975. The Treasury bill rate fell to 4.4 percent in December 1976 from the August 1974 high of 8.7 percent. Real GNP growth turned up strongly in the year over year, inflation dropped to 5.2 percent in 1976, from 8.7 percent in 1974 and 9.2 percent in 1975. The Treasury bill rate fell to 4.4 percent in December 1976 from the August 1974 high of 8.7 percent. Real GNP growth turned up strongly in the second half of 1975. It was 5.4 percent in 1976 versus 1975 as a whole, and unemployment fell from 8.9 percent in May 1975 to 7.4 percent in January 1977.

Unfortunately, beginning in 1977, the Federal Reserve again permitted rapid M1 growth. It averagd 7.5 percent a year in the 1977 to 1980 period. In association, inflation and interest rates rose again. Inflation averaged 7.7 percent a year in the 1977 to 1980 period and reached 9.0 percent in 1980. The Treasury bill rate increased from 4.4 percent in December 1976, to 6.1 percent in December 1977, to 9.2 percent in Decmber 1978, to 12.1 percent in December 1979, and to 15.7 percent in December 1980.

No real sector gains resulted from stepping up M1 growth either in the 1977 to 1980 period or in the 1965 to 1974 period. In the 1965 to 1974 period, year-over-year real GNP growth was 2.9 percent versus 3.6 percent in the 1954 to 1964 period, and unemployment averaged 7.0 percent, versus 5.4 percent in the 1954 to 1964 period. In the 1977 to 1980 period, real GNP growth averaged 3.0 percent a year and unemployment averaged 6.5 percent. Moreover, in 1980, real growth actually declined 0.4 percent and unemployment averaged 7.2 percent.

The lesson is clear. We cannot inflate our way, that is paper or print our way, to real prosperity and full employment. The record warns against money growth which is too fast, too long.

President Reagan inherited a monetary policy problem when he came into office in January 1981. M1 growth had soared to over 13 percent per year in the second half of 1980, the Treasury bill rate averaged 15.7 percent in December 1980. The unhappy choice that had to be made was between gradual reduction of M1 growth or a sharp deceleration. Slowing money growth slowly from the 13 percent per year level meant reducing inflation only slowly but keeping the economy from receding sharply. Decreasing M1 growth rapidly meant courting a major recession but breaking inflation quickly.

The Administration urged that the growth of the monetary base (and thereby M1 growth) be reduced slowly, 0.6 to 1.0 percentage point a year. For reasons that are not clear, the Federal Reserve allowed M1 growth to drop very sharply beginning in April 1981 and continuing through July 1982. In that period, annualized M1 growth was only 3.3 percent, significantly lower then the 7.5 percent per year average of the 1977 to 1980 period. The sharp deceleration of M1 growth helped send the economy into a recession beginning in the second half of 1981. However, it also helped to slash the inflation rate in half, and interest rates, albeit with a lag, have been following the inflation rate downward.

Since last August, M1 growth has again been accelerating sharply. It increased at an annual rate of 12.7 percent from August 1982 to January 1983. The rapid runup in money growth since last August has increased the quantity of the M1 measure of money to a level slightly above where it now would have been if the Federal Reserve had followed the Reagan Administration's original plan of decreasing M1 growth steadily by 0.6 to 1.0 percentage point a year. With a strong recovery underway, it is time to again rein-in the growth of M1, but this time it must be done gradually. If the

Administration's original track for M1 growth had been followed, M1 growth would have been 6 to 6.5 percent in 1982. Since the level of M1 is now about where it would have been if that track had been followed, the sensible policy to pursue now is to follow the original track in 1983 and subsequent years. Accordingly, we recommend that M1 growth be constrained to 5.0 to 6.0 percent in 1983 and reduced by 0.6 to 1.0 percentage point a year in the 1984 to 1986 period. This policy will promote sustained recovery and a gradual return to full employment without reigniting inflation and sending interest rates to much higher levels once again.

VI. INTERNATIONAL

Recommendation

The United States should step up efforts to increase exports to foreign markets and strongly resist protectionist measures at home.

International economic forces have taken on increasing importance in the United States over the past decade. Four out of five new manufacturing jobs have been created by international commerce. One out of every three acres is planted for export, and trade in general accounts for an ever-increasing share of our Gross National Product. Given the role of trade in providing jobs and domestic and international sales opportunities, we should adopt those policies that will ensure expanded export markets and should avoid increased protectionism.

Since World War II, the liberalizing influence of successive rounds of multilateral trade negotiations under the 89-country General Agreement on Tariffs and Trade (GATT) fostered substantial growth in world trade, i.e., at a 7.1 percent annual rate from the mid-1940's to the early 1970's. The oil price shocks and competition from developing countries slowed this growth substantially, however, and the value of world trade actually declined one percent in 1981; 1982's trade volume remained stagnant, with the United States particularly hard hit by import pressure.

In 1982, the United States suffered a $44 billion balance of trade deficit. This shortfall is estimated to rise to $75 or $80 billion in 1983, particularly as a result of the overvalued dollar's upward price pressure on U.S. goods and services. This deficit is directly subtracted from GNP and in large part accounts for 1982's slow growth and high unemployment.

In this difficult international economic climate, the members of GATT met in Geneva in November 1982 to renew their commitment to expanded world trade. The Contracting Parties committed to "refrain from taking or maintaining any measures inconsistent with the GATT" and to "resist protectionist pressures." However, the European Community, in particular, refused to discuss a near-term extension of GATT rules to deal effectively with agricultural trade problems. Thus, EC export subsidies for products such as wheat flour, poultry and pasta remain, despite U.S. complaints that such subsidies deprive us of an equitable share of the world market. Japanese import quotas on citrus fruits and juices, beef and other farm products remain outside of GATT scrutiny, as well.

During the GATT Ministerial, the United States made some progress in establishing a GATT study of the impact of international trade in services, such as banking, insurance, communications, and data processing, and of the barriers to such trade. However, we could not persuade other countries to undertake a similar examination of trade in high technology products, such as computers, electronic components and aircraft.

Notwithstanding the impact of the current trading environment here at home and the unwillingness of our foreign partners to open markets immediately, we should resist the use of protectionist measures. Government intervention in one sector of the economy can distort trade and investment flows in that sector and elsewhere. Protection, in the form of higher tariffs, import quotas or "Buy American" provisions, should therefore be provided only under the most serious circumstances.

At the same time we reject protectionism at home, however, the United States should increase its efforts to combat unfair practices on the part of our trading partners. Predatory trade measures, e.g., industry targeting, insidious domestic subsidies, export aids and cartel arrangements, deny U.S. producers an equitable share of the world market and should be removed. The United States must, however, develop careful and measured responses designed to restore our legitimate competitive opportunities rather than implementing actions that will promote a beggar-thy-neighbor trade war. Such a trade war could have a devastating impact on the debt-ridden developing countries who rely on exports to the industrialized world for much of their survival.

In addition to outright protectionism, this rising world debt problem also constitutes a threat to world trade. Over the last year, developing country debt has risen to an incredible $700 billion, with a major share held by Latin American nations. Since 1978, high interest rates have boosted the cost of servicing such debt, forcing countries to reschedule nearly $11 billion in repayments in 1982. While the sharp fall in U.S. rates beginning at the end of last year eased the debt cost for major borrowers, a severe crisis continues. Mexico, for example, has had to agree to numerous austerity measures in order to obtain a three-year $4 billion loan agreement with the International Monetary Fund. Brazil was forced to devalue its currency by 30 percent and to conclude a $4.9 billion credit agreement with the Fund in order to meet its financing needs for 1983. This agreement is conditioned upon the willingness of Brazil's commercial creditors to increase their lending, as well. Argentina's agreement was for a $1.6 billion IMF loan based on a rescheduling of existing debt as well as the securing of an additional $2 billion in new commercial loans.

While, through a combination of Fund credit and increased commercial bank commitments, the developing countries should be able to avoid default this year, the present debt crisis points to the need to take a closer look at how we reached the present state of commercial bank overexposure and vulnerability. Congress should undertake to determine the inter-relationship between government actions and commercial bank lending. Useful areas of inquiry would be, for example, the extent to which banks have lent on the basis of governmental foreign policy goals rather than on sound financial considerations. In addition, we should consider what role the Federal Government should reasonably play in supporting U.S. commercial banks when these institutions face major loan defaults.

High interest rates, which have exacerbated world debt problems, have also affected the United States by raising the value of the dollar. Over the course of 1982, the dollar rose as much as 40 percent against many major foreign currencies. As a result, U.S. goods and services have become relatively more expensive than comparable foreign products in the international marketplace. The largest single factor in the dollar's surge has been the high real interest rates, which have increased the attractiveness of the U.S. market to foreign suppliers of credit. In addition, currencies, such as the Japanese yen, have been abnormally depressed, further widening the gap and placing American traders at a competitive disadvantage vis-a-vis their Japanese counterparts. Since late October, the yen has risen by approximately 11 percent against the dollar and 7 to 8 percent against the German mark. Despite a $7 to $8 billion infusion to bolster the yen in 1982, it has depreciated 15 percent in real terms over the past two years.

Recognizing the adverse impact the overvalued dollar has had on the U.S. balance of trade, the United States should nevertheless avoid foreign exchange market interventions except under conditions of severe distortion. Over the long term, the elimination of inflationary expectations and a concommitant reduction in interest rates will have the most positive impact on exchange rates and currency misalignment.

Another factor currently influencing the international economy is the dissolution of OPEC. In sharp contrast to 1974 and 1978, the world economy is facing not a massive increase in the price of oil but a massive glut of one of our most valuable natural resources. The combination of worldwide economic downturn, increased conservation efforts, and greater use of alternative energy sources has reduced the demand for oil and led to dwindling production by the countries that comprise the OPEC cartel.

According to OPEC's Research Group of Petroleum Exporters' Policies, OPEC lost 12 million barrels per day in production between 1979 and 1982. Moreover, as a result of the glut, we have seen as much as a 25 percent decline in the real price of oil since March 1981. At present, the OPEC benchmark price is $34 per barrel, with the average effective effective price closer to $32.

While we should welcome these declining prices, since they herald a freeing-up of scarce capital for other consumption and investment opportunities, there may be problems associated with a sudden price drop in oil. Developing countries like Mexico, Venezuela, and Nigeria, for example, would see their oil-related income decline, further weakening already fragile economies. However, this should be more than offset by improvements in the balance of trade for such oil importing countries as Brazil.

Nevertheless, on balance, a reduction in oil prices should be hailed as a positive development.

The Administration has asked that we go along with the proposal by the Board of Governors of the International Monetary Fund (IMF) to increase its quotas by $32 billion and expand the General Agreement to Borrow (GAB) by $12 billion. The cost to the United States would be $8.4 billion. The proposal is prompted by the current international debt crisis. The new moneys will not be paid into the IMF until late 1983 or even early 1984. New economic trends, including lower loan rates and the U.S. recovery, together with actions taken in conjunction with the IMF by Argentina, Brazil, Mexico, and other debtor nations to improve their trade and current account balances, and by creditor-banks to roll-over maturing loans and extend new credits, will help to solve the debt crisis. A rather positive view along these lines was set forth by the World Bank in issuing its annual "World Debt Tables." However, the proposal of the Administration would be a type of "insurance" for solving the long-term debt crisis.

VII. AGRICULTURE

Recommendation

The Administration and the Congress should immediately consider major changes in supply-control and demand-enhancing farm policies and programs. Market discipline can be improved, thereby reducing the budgetary cost of farm private support programs, while at the same time improving the financial picture of American farmers.

Since the 1930's, U.S. farm policy has had the dual objective of encouraging the production of adequate supplies of food and fiber so as to maintain reasonable prices for consumers, and, at the same time, assuring farmers a fair return on their investment and efforts. Four measures are commonly employed by the Federal Government to balance these conflicting consumer and former interests: direct payments to farmers, nonrecourse loans, acreage reduction programs, and export promotion activities. Most agricultural price support and related activities are carried out by the Commodity Credit Corporation (CCC) of the United States Department of Agriculture. Including the projection of the Congressional Budget Office for Fiscal Year 1983, CCC realized losses on commodity price and farm income support programs for the last four years will exceed $35 billion.

From the consumer perspective, traditional farm policy has been exceptionally effective. Food and fiber supplies are not only adequate but border on the extravagant. Never has a society been provided with more abundant supplies and a wider variety of nutritious food. The consumer price index for food and beverages during the last four years has advanced 21.8 percent compared to a 33.0 percent increase in the prices of all consumer goods and services. Americans now spend a smaller proportion of their income on food than any other people on earth.

Farmers, however, have not fared as well. According to the United States Department of Agriculture, 1983 will likely mark the fourth consecutive year of declining and record low net farm income. In 1982, real net farm income was one-fourth the level achieved by farmers 10 years ago and roughly equivalent to that realized in 1933. After three consecutive years of implementing increasingly costly acreage reduction programs, surplus carryover stocks for virtually all grains and cotton approach record levels. Government-owned stocks of dairy products, acquired under the dairy program, are at record levels. In constant dollars, the net income-to-equity ratio for U.S. agriculture has trended down from 10.0 percent in 1973 to 2.2 percent in 1982.

TABLE VII.1.—NET INCOME-TO-EQUITY RATIO FOR U.S. AGRICULTURE (1972 to 1982)

Year	Net income [1]	Equity [1]	Income/equity ratio (percent)
1972	15.1	233.5	6.5
1973	25.1	247.9	10.0
1974	17.6	274.4	6.4
1975	15.6	260.6	7.9
1976	11.0	285.2	3.9
1977	10.2	310.6	3.3
1978	13.6	312.5	4.4
1979	14.9	336.9	4.4
1980	8.2	342.3	2.4
1981	9.2	333.2	2.8
1982	6.7	305.8	2.2

[1] Billions of 1967 dollars.

Farm commodity programs, specifically their price support provisions, have proven to be counterproductive in achieving fair returns to investment in agriculture. An increasingly larger share of U.S. argriculture's output is being "sold" at the loan rate for long-term storage in government warehouses rather than being competitively priced and purchased in the marketplace and consumed. In 1982, the government incurred a storage expense of close to $500 million just for the grain reserve. U.S. loan rates are considered by our foreign competitors as price ceilings. The United States Government, not the international marketplace, therefore, must accommodate U.S. farmer-produced supplies as long as world prices remain below loan rates. Loan rates, in effect, protect world farmers and their governments from feeling the full clout of the U.S. farmers' competitiveness. The United Sates is losing export sales as a result, and the role of nonrecourse loans in future farm policy needs to be carefully considered in that light.

Target prices have gained the reputation as constituting the closest the American society gets to providing a sector of its populace with a guaranteed income. But U.S. farm policy has, in fact, had the effect of guaranteeing farmers a loss. For example, wheat farmers in 1983, who reduce their planted acreage 20 percent and satisfy all other program requirements, are entitled to a minimum price of $4.30 per bushel for the amount of wheat they do produce. Target prices are legislatively determined and are generally believed to be below the cost of production and above market-clearing price levels. Relative to the target price of $4.30 per bushel, wheat is presently selling for $3.90 per bushel in Kansas City and, according to Chase Econometrics, the cost of growing a bushel of wheat in Kansas is $5.22 per bushel. The U.S. farmer is apparently becoming more and more remote from his marketplace and, as a result, his production decisions are more a consequence and reflection of political activity in Washington than of supply and demand forces in Kansas City. Importantly, it is market forces which promote efficiency, and greater economic efficiency is one means to both increase farm income and reduce food and Treasury costs.

Yet, the public most definitely has a vested interest in the continuance of food supplies in adequate quantities, quality and variety provided at reasonably stable prices. It is estimated that 20 percent of the U.S. gross national product and as many as 20 million jobs are directly or indiretly related to the production of food and fiber. In addition, agricultural export sales have become a major means of earning foreign exchange and helping maintain a strong dollar, thereby lowering the cost of imported goods and services. The United States Government also extensively uses the products of American farmers to achieve public welfare and foreign policy objectives, through the food stamp and Food for Peace programs. Therefore, there is ample justification for the public to assume some degree of the risk associated with farming through the provision of a necessary level of income maintenance support. However, target prices should be made administratively more flexible and set closer to market-clearing levels so that farmers will be given more appropriate market signals. Effective production restraint by farmers will result in higher market-clearing prices and therefore higher income support levels. Conversely, overproduction will drive prices down and lower prices will help more quickly to eliminate surpluses.

Public support of the farm sector should emphasize the promotion of export sales—meeting international market challenges and pursuing international market opportunities—as a means of increasing demand and, therefore, market clearing prices. The United States Government should assume the obligation of aggressively representing in the international marketplace the most efficient food producers in the world when and where necessary. Agriculture is a U.S. international advantage well worth defending.

Substantial evidence exists to support the need to challenge the current effectiveness and question the future appropriateness of traditional farm policy in satisfying its primary client, the farmer. The debate will be intense and controversial; but the debate must proceed.

ADDITIONAL VIEWS

ADDITIONAL VIEWS OF REPRESENTATIVE MARJORIE S. HOLT

The Republican Members of the Joint Economic Committee are correct in their assumption that a strong economic recovery is already underway and we must avoid reinflating the economy with a burst of stimulus spending and/or excessive monetary growth.

The greatest danger confronting the economy in the next few years is deficit spending on so large a scale that it would crowd out the private sector by raising interest rates and force inflationary increases in money supply to accommodate government borrowing.

A strong rate of economic growth will reduce annual budget deficits by increasing revenues and reducing outlays associated with unemployment, but this alone will probably not reduce the deficits to acceptable levels.

I agree with my Republican colleagues that some savings are possible in the defense budget, but a realistic appraisal of defense needs leads me to assume that the savings will not be as large as my colleagues would hope for.

To those who suggest that we cut operations and maintenance accounts in the defense budget, I ask whether they are willing to sacrifice readiness. To those who would freeze pay and benefits, I ask how we will recruit and retain military personnel of good quality. To those who would spread procurement costs over additional years, I say this will surely increase unit prices and increase the total cost of those weapons systems and equipment in the final analysis.

Defense claimed 40 percent of the Federal budget in 1970, but only 23 percent of the budget in 1980. This year defense has almost 27 percent of the budget and next year might go to 29 percent, or 7 percent of GNP.

Critics are complaining that we cannot afford to spend 29 percent of the Federal budget on the foremost responsibility of the national government. They are upset that defense will have 34 percent of the Federal budget in fiscal 1988 if President Reagan's program is fully implemented.

Savings are possible, but there is a consensus in Congress that the defense budget must continue to show substantial real growth in the 1980's after the cuts that were imposed in the 1970's. There is a consensus that we must not allow Soviet advantages in military capability to grow to overwhelming advantages that would place the freedom and life of every citizen of the Free World at risk.

Obviously, we must pay for effective and credible military strength, one way or another, and at the same time that we confront the imperative of reducing budget deficits.

Faced with this dilemma, I would be willing to consider the repeal of tax indexing scheduled to begin in fiscal 1985.

Perhaps it is unpopular to say this, but I believe Congress made a big mistake in 1981 by promising that the individual tax burden would be adjusted for inflation on a permanent basis beginning in 1985. That was not part of President Reagan's original tax reduction package, but was among the ornaments Congress hung on the tree.

I have never taken an expansive view of the responsibilities of government, but I recognize that we must have sufficient revenues to fulfill the responsibilities it must perform.

On the one hand, we are required to continue our defense rebuilding effort to deter the perceived threat to our national security. On the other hand, the future health of our economy depends on reducing annual budget deficits of enormous size.

Under the circumstances, allowing tax indexing to take effect in 1985 and proceed through the ensuing years would probably be unwise.

ADDITIONAL VIEWS OF REPRESENTATIVE OLYMPIA J. SNOWE

I want to lend my strong support to the Republican Views of the Joint Economic Committee and to praise Chairman Jepsen for his leadership and dedication in producing a useful document. Through this report, it is my hope the Congress will benefit from the viewpoints presented by the Joint Economic Committee and the recommendations that are contained in the body of this report.

Curing the ills of our economy will not be easy. The high federal deficits the pervasive nature of unemployment, the prospects of renewed inflation, the growing foreign debt problem, and the many pressing human needs are problems that cannot be solved in a short period of time. Our recommendations are intended to produce a strong economy, but recongnize that short-term, quick-fix solutions often produce long-term problems of an ever greater magnitude.

Whatever created our current problems in not my primary concern. Congress should not dwell on the mistakes that we and others have made in the past, but rather we should carefully scrutinize our actions to determine their effects in the future. Too often our actions are reflective of short-term pressures, and pay little attention to the future implications. This leads to stop and start policies, personal and business uncertainty, and an uneven economy. More attention should be paid to the long-range effect of the actions we take, and our goal should be a healthy and stable economy.

I would agree with the recent economic report that our economy is beginning to recover. I remain guarded in my optimism regarding the recovery, however, particularly in view of the many pitfalls pointed out to the Committee by several prominent economists. A great deal of doubt remains about the strength and length of the recovery. The actions we take in Congress, as well as those taken by the Reagan Administration and the Federal Reserve Board, should recognize the fragility of the recovery, and the need for policies that build on the progress that has been made at this time.

The Reagan Administration has taken many positive steps toward producing a better economy. The reduced rate of inflation and the lower interest rates are praiseworthy. While the Administration has been much criticized for the areas and amounts of their budget reductions, I applaude them for the honesty with which they have addressed the Federal budget crisis. I have many differences with the specific budget levels recommended by the Administration, but I feel they have accurately captured the public mood, as well as the economic necessity, to reduce Federal spending.

Much debate will focus in the coming months on efforts to delay or repeal indexing of the income tax rates. While this might result in a significant reduction in the future deficit, it would also be an indirect method of increasing taxes. Such a tax increase would fall most heavily on the lower income classes and as such I do not think it would be the most preferable course of action. The ever-increasing budget deficits must be reduced, however, and all methods of deficit reduction should be reviewed by Congress. Delay of indexing would not be my first choice to reduce the deficit, but it should not be eliminated from the options to consider.

The level of defense spending should receive considerable review. Our military capability should not be harmed by any adjustments in defense expenditures, but I believe the military budget should receive the same scrutiny for possible savings as the rest of the budget has already received. The health of the overall economy will improve if the budget deficits can be decreased. As the overall economy improves, our defense expenditures can again play a positive role in our economy.

Of particular concern to me are proposed spending reductions in programs designed to protect against, or relieve human suffering. Extremely important to my region is adequate funding for low-income energy assistance and home weatherization. Funding for health care should be maintained at a level necessary to assure that proper attention is given to those in need. Our government cannot turn its back on those that are suffering, and Americans living in poverty must be given as much assistance as possible to help them improve their quality of life. The basic social safety net that consists of Federal, State, and local programs must not be weakened. The Federal responsibility to provide assistance to the needy is clear, and additional burdens should not be transferred to the States, to local governments, or to the private sector.

One area where much improvement needs to be made is unemployment. The overall rate is far too high, and unemployment among certain subgroups is at tragic levels. I recognize the human suffering caused by unemployment and strongly endorse the recommendations of the Joint Economic Committee report designed to reduce unemployment. Special attention should be made to the problems of women in the work force, a subject I will deal with in greater depth later in these views.

The strong employment record of small business should be recognized, and efforts should be made to promote the activities of all sectors of our small business community. Employment programs should address the role of regional industries in the economy of our country and steps should be taken to insure the health of our many regional industries. Above all, unemployment should not be dealt with as a statistical problem, but we should be ever mindful of the personal effects of unemployment, underemployment, or the fear of unemployment, on every member of our society.

As a member of the Foreign Affairs Committee, I am well aware of the special trade problems of our country. We are dependent on other nations to an ever greater degree, and the world economy is closely tied to the economy of the United States. Both our export policy and our import policy are important to me, and I am outlining my views in greater detail in a later section of these views.

WOMEN AND EMPLOYMENT

The tragically high rate of unemployment in this country, as well as the near certainty that Congress will proceed with legislative measures to provide some relief to those who are out of work, demands that we focus renewed attention on the problems of women in the work force, and how they can be best addressed by employment initiatives in the 98th Congress. I include these additional comments because I do not believe the plight of women in the work force has been adequately addressed any where in recent discussions of this country's employment picture.

In January 1983, nearly 48 million women, 16 years and over, were in the labor force. Forty-three percent of the American labor force is comprised of women. This number has doubled in the last 20 years, and by 1990, women are expected to comprise more than half of all our nation's workers.

While women's participation in the labor force has increased, their pay has actually decreased. In 1955, women earned only $.64 for every $1 earned by a man. Incredibly, this has decreased to $.59 to every $1 earned by men today. In 1981, women workers with four or more years of college education earned approximately the same income as men who had only one to three years of high school, while women high school graduates earned less than men who had not completed their elementary school.

One of the primary reasons for this gross disparity in pay continues to be the concentration of women in traditional, low-paying, dead-end jobs. In 1981, women were 80 percent of all clerical workers, 63 percent of all retail sales workers, and 89 percent of all health service workers. At the same time, they were only 4 percent of all engineers, 14 percent of all doctors and laywers, 7 percent of workers in heavy construction, and 1 percent of all truck drivers.

Women work for the same reason man do—economic necessity. Two-thirds of all working women are single, widowed, divorced, or separated, or have husbands who earn less then $15,000 a year. Additionally, a growing proportion of American families are headed by women. Tragically, almost one in three female-headed families lives in poverty today, as contrasted to one in 18 headed by a man. Three-fourths of the poor are women, a phenomenon that has recently been described as "the feminization of poverty." The most vulnerable women are elderly and single female heads of household. The costs of unemployment to these women, their families, and society are enormous.

In January 1983, 10.0 percent of women 16 and over were unemployed, and certain groups of women have been much harder hit. Women who maintain families, for example, suffer from an unemployment rate of 13.2 percent, while the figure approaches 50 percent for young, black women.

Women make a vital contribution to the labor force of this country and share the same devastating results of unemployment. Public policy discussions must go beyond the traditional, but totally inaccurate concept that unemployment is not really a woman's problem because women don't really need to work. This simply is not true, and steps must be taken to insure that any legislative program adopted by the Congress will provide relief to all of this nation's unemployed—not just to one group.

I, therefore, recommend that any legislative program meet the following specific objectives: (1) that women be assured of this government's commitment to eliminate discrimination in employment, (2) that employment stimulation be balanced over a wide range of job types, (3) that the specific employment needs working mothers face in meeting the demands of their dual career be addressed, and (4) that women's long-term employment and economic security be strengthened through job retraining programs that specifically seek to overcome sex-stereotyping in employment. I would like to elaborate briefly on each of these objectives.

Women continue to suffer from pervasive discrimination in wages and hiring, despite the passage of major legislation designed to address these programs. The Equal Pay Act of 1963, Title VII of the Civil Rights Act of 1964, and Executive Order 11246 can be effective tools, if rigorously enforced. But women have been forced to confront a government that has not measured up to its responsibility for eradicating employment discrimination. Therefore, it is vitally important that antidiscrimination provisions consistent with existing law be included in the language of any jobs legislation, and that they be rigorously enforced. A commitment to pay equity must be affirmed as well.

I also believe that we must balance employment stimulation over a wide range of job types from public works to public services. The recent debate on the various jobs bills proposed in the 97th Congress to repair highways, bridges, and mass transit, and the eventual passage of a gas tax to fund these jobs, exemplified the deeply held assumption that unemployment is not really a woman's problem. In fact, 98.3 percent of construction workers in this country are male, and when efforts are made to fund jobs to repair highways, bridges and mass transit, the assistance goes primarily to employ men. Any jobs legislation passed by Congress must insure that the jobs created will offer realistic employment opportunities to women. This country has great needs for the rebuilding of its infrastructure, and those have received an abundance of attention recently. However, two years of greatly reduced domestic spending have created a considerable need for increased services to the elderly, poor, and children. Jobs created in the public service area will both help to meet those needs and provide jobs that are more consistent with the skills and employment interests traditionally held by women.

Any serious consideration of women's employment problems would be grossly deficient without efforts to address the specific employment needs working mothers face in meeting the demands of their dual role as workers and caregivers. Funding for day care has been greatly reduced over the past few years. Adequate funding for child care resources must be an essential part of any employment initiative that seeks to address women's employment needs. Additionally, provisions encouraging the development of alternative work schedules should be included to realistically enhance women employment opportunities.

Finally, and very importantly, it is vitally important that efforts be made to move beyond the placement of women into traditional low-paying jobs, and strong steps be taken to encourage the entrance of greater numbers of women into nontraditional fields. Provisions for occupational development, upward mobility, development of new careers for women, and overcoming sex sterotyping should be included as we enact new job training and job creation programs. In particular, the rapid movement of our economy toward a complex, highly technical job structure, presents a critical opportunity for women to prepare to enter and advance in parity with their male counterparts into this new field.

Tragically, women are in a state of double jeopardy at present. They suffer from persistent and totally intolerable wage and hiring discrimination on the one hand. On the other hand, they face the same critical problems that confront all unemployed workers in the country today. It is essential that the 98th Congress recognize this serious problem and take strong steps to address the specific problems confronting women as they fight for economic security.

TRADE

No one can doubt the importance of trade to the U.S. economy. We rely on other countries for certain goods, and our exports are critical to the economy of our country. But there must also be the realization that parts of our economy may be hurt by foreign trade. The actions of other countries must be carefully monitored and actions should be taken if harm is done to our domestic economy.

The United States may currently be a victim, not a beneficiary of its open market policies. Our economy is directly disturbed when our foreign trade partners help themselves to larger and larger portions of our consumer markets while denying access to their domestic markets. It is time to put our foreign competitors on notice that the slogan "free trade must be fair trade" is not just simple rhetoric. I do not advocate passing protectionist legislation, but I submit that it must be clearly understood that all bilateral trade relations with the United States will be equitable out of necessity.

A case in point from my home state of Maine involves the shoe industry. Maine is the leading footwear producing state in the nation, employing 17,000 people. Yet, significantly as that figure appears, it is less by 7,000 jobs since the late 1960's. Those job decreases can be directly attributed to the flood of foreign, low-cost shoes that have been dumped on U.S. markets. Foreign material costs and wage differentials are certainly a major factor accountable for the decline, but the problem goes beyond that. In many instances, the shoe exporters have gone one step further and are denying market access to U.S. shoe exporters. For all intents and purpose, the foreign shoe manufacturers are having their cake and eating it too by monopolizing their domestic markets, maintaining full production and exporting, at the expense of U.S. shoe manufacturers millions of pairs of shoes. I do not think that anyone would characterize this trade situation as fair or equitable.

Restricting market access is only one method by which the U.S. global trade position suffers. Another serious roadblock to free and fair trade is heavy subsidization by competing governments. Canada is a prime example of a government which subsidizes certain industries, often with great harm to our domestic markets.

Canadian lumber exports to the United States has reached almost $2 billion annually. Certainly, that level of exports does not come about as a result of lack of supply in the U.S. side of the border. It is a documented fact that the Canadian government is heavily interventionist in their industries, and offers the lumber business a vast quantity of loans, grants, rail rate discounts, wage assistance, and inventory financing, while selling public timber well below market value. Consequently, the Canadians are able to severely undercut the products of the U.S. lumber industry and that proof is dramatically illustrated by the fact that the Canadian share of the U.S. lumber market has grown steadily over the last 20 years from 13 percent to over 30 percent. One other effect has been increased unemployment in the U.S. lumber industry. In some segments, idleness has reached a disastrous level of 50 percent of the work force. A good portion can be attributed to the subsidized exports of the United States. Clearly, this is another example of an unfair trade practice which aids the exporter while inflicting damage on our domestic market.

Similar claims can be made about the Canadian fishing industry. The Canadian Fishing Vessel Construction Program provides up to $50,000 for the purchase of new fishing gear or can be put to use for refurbishing an older fishing vessel. Canada also provides tax exemptions for boat fuel and fishing gear. Unemployment insurance is provided for Canadian fishermen even though they are self-employed. It is no wonder that over 50 percent of the fisheries products used in the United States are imported. Of those imports, Canada supplies nearly one-half a billion dollars worth, which is equal to 90 percent of all of Canada's fish landings. It would appear that Canada is supplying these subsidies because of a conscious decision to support the Maritime fisheries as a less costly alternative to widespread welfare and the social losses that would result from the decline of the fishing industry.

The United States must follow an even course on trade policy. I agree that considerable attention should center on efforts to increase our exports, but attention should also be paid to our import policy. We should not look only to markets in other countries for our goods, but we should make every effort to encourage a healthy domestic market for our products.

DEMOCRATIC VIEWS ON THE FEBRUARY 1983 ECONOMIC REPORT OF THE PRESIDENT

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Monetary policy should accommodate sufficient economic growth to reduce unemployment in 1983 and 1984.

Fiscal policy in 1983 should support economic recovery. Immediate steps to provide relief to low-income people and to improve tax fairness will promote this objective.

Fiscal policy decisions this year for Fiscal Years 1984-1986 and beyond should sustain recovery. Much lower deficits, achieved through a reduction in the proposed military budget and other spending and through a more fair tax system, will promote this objective by encouraging lower long-term interest rates.

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Recommendation No. 2: The Federal Reserve should ease money and credit to achieve low real interest rates early in 1983, and should sustain such rates through 1984.

Recommendation No. 3: Better coordination of monetary and fiscal policies should be achieved through the budget process. The Federal Open Market Committee's official projections for growth, inflation, and employment should be made consistent with the economic assumptions of the budget resolution.

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Recommendation No. 4: Congress should authorize and fund a significant jobs program.

Recommendation No. 5: Congress should provide additional support this year for food, fuel, housing, and health care to low-income people.

Recommendation No. 6:

The Federal Supplemental Compensation program should be extended to provide 10 additional weeks of coverage to those who have exhausted benefits, and to provide the current level of coverage for workers who become newly eligible over the next nine months. Proposals to cut eligibility for FSC by increasing the number of weeks worked in the base period should be rejected. Consideration should be given to the use of a national unemployment rate trigger as steps to reduce the Federal deficit take effect. Congress should suspend changes in the Extended Benefit program that restrict availability of the program in certain states, and extend the two-year grace period on repayment of Federal loans to state unemployment insurance programs.

Recommendation No. 7: Congress should provide fiscal assistance to state and local governments this year to avert sharp cuts in public services and regressive tax increases. Such assistance should be phased out as the economy recovers. No counterproductive cuts in programs benefitting state and local governments should be made this year.

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Recommendation No. 9: Congress should put in place in 1983 a fair and effective deficit reduction program for Fiscal Years 1984–1986.

Recommendation No. 10:

Personal income tax indexing should be repealed.

The base of both the personal income tax and of the corporate income tax should be broadened, with special emphasis on the elimination of tax expenditures which are obsolete, inefficient, or particulary regressive, and on reform of depreciation schedules to improve the neutrality of the tax code with respect of different classes of investment.

We oppose proposals for broad-based, regressive consumption taxes.

Recommendation No. 11: Military spending increases should be slowed for the immediate future by more prudent decisions with respect to weapons systems and to procurement, rather than through cuts which will affect the recruitment and retention of qualified military personnel or their combat readiness.

Recommendation No. 12: Entitlements programs should not be exempt from review as part of the broader effort to reduce budget deficits in future years.

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Recommendation No. 21: Equal employment opportunity laws should be enforced vigorously, with adequate funding for enforcement activity.

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Recommendation No. 22: Education at all levels must be improved. Federal funds should be provided to raise the technical level of primary, secondary, and higher education, and to assure more equal educational opportunity across all regions, and for the disadvantaged.

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Recommendation No. 24: Programs to support industry should be designed to take advantage of new opportunities while retaining our old, productive strengths. The key ingredients include:

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Recommendation No. 26: Congress and the Administration must increase efforts to expand farm exports.

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Recommendation No. 28:

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A full review of Fiscal Year 1984 funding for GNP source data should be undertaken.

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I. To Restore Growth

Recommendation No. 1

Congress, the Administration, and the Federal Reserve should act to achieve a high rate of economic growth in 1983 and 1984. The following mix of policies is required:

Monetary policy should accommodate sufficient economic growth to reduce unemployment in 1983 and 1984.

Fiscal policy in 1983 should support economic recovery. Immediate steps to provide relief to low-income people and to improve tax fairness will promote this objective.

Fiscal policy decisions this year for Fiscal Years 1984–1986 and beyond should sustain recovery. Much lower deficits, achieved through a reduction in the proposed military budget and other spending and through a more fair tax system, will promote this objective by encouraging lower long-term interest rates.[1]

The Administration has presented a frank view of the most likely course of the economy for 1983 and subsequent years. However, this course is not acceptable. We believe that the policies recommended in this Report will yield more rapid economic growth and a faster reduction in unemployment than under the Administration forecast, without leading to an acceleration of inflation. While inflation remains a danger, in the current phase of the business cycle, renewed inflation is not the major risk. Indeed, stronger recovery over the next couple of year could in some ways further reduce the inflation rate.

We favor a more rapid growth rate of output because that means a more rapid reduction in unemployment after the peak unemployment rate is reached. The unemployment rate will fall only if output grows faster than the total of the rates of increase in productivity and the labor force. If productivity were to grow by 2.5 percent and the labor force by 1.5 percent, modest in comparison with past recoveries, output would have to rise by at least 4 percent simply to maintain the unemployment rate at the current level. For this reason, we regard growth more rapid than 4 percent in the year ahead as essential.

The achievement of 5.5 to 6 percent real annual growth in the first full year of recovery is a realistic goal. Following six previous recessions since World War II, economic growth in the first year of recovery was at or above this range five out of six times, as shown in Table I. With the exception of the excessively rapid recovery during the Korean War, stronger upturns have not led to higher inflation. In the most recent sustained upturn, following the 1973-1975 recession, real GNP rose at a 5.7 percent annual rate over a two and a half year period, leading to a reduction in the unemployment rate from 9 percent to less than 6.5 percent, without accelerating inflation.

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[1] Representative Hawkins states: "While deficit reduction is important and necessary, too much attention is being placed on reducing the deficit as the means for sustaining economic growth. Deficit reduction is a desired end result. The most effective way to promote this objective is by increasing employment and production with proper attention to the priority needs of the American people and the economy. The achievement of full employment with price stability after an initial increase in properly targeted budget outlays will produce growth that will provide the addition of revenues needed to lower the deficit and eventually balance the budget."

TABLE I.—REAL GNP GROWTH AND UNEMPLOYMENT RATE, POSTWAR RECOVERIES

[In percent]

Real GNP through quarter	Real GNP growth over following—		Through quarter	Unemployment rate following through—	
	4 quarters	8 quarters[1]		4 quarters	8 quarters
1949:IV	13.3	9.6	7.0	4.2	3.4
1954:II	7.4	5.0	5.8	4.4	4.2
1958:I	6.9	5.5	6.3	5.8	5.1
1960:IV	6.4	5.1	6.3	6.2	5.5
1970:IV	4.7	5.8	5.8	5.9	5.4
1975:I	6.7	5.4	8.3	7.7	7.5
Average[2]	7.6	6.1	6.6	5.7	5.2
1982:IV[3]			10.7		

[1] Average annual rate of growth.
[2] Excludes the abbreviated 1980 recovery, when real GNP rose for only 3 quarters (1980:III-1981:I).
[3] Real GNP growth and unemployment rate based on administration forecast.

Faster growth at this time, with so much slack in the economy, would actually restrain inflation in the short run through higher productivity growth, which lowers the rate of increase in labor cost per unit of output, the major component of the cost of production. At the same time, lower interest rates would reduce costs directly, and contribute to a more rapid recovery of investment, which would mean more productivity as the recovery matures. Lower inflation resulting from productivity improvement would build on itself—a sustained improvement of 1 percent in our productivity growth rates would, over time, reduce the inflation rate by more than 1 percent.[2]

To achieve a higher growth rate this year and to sustain it through 1984 will require prompt action to change the course of both monetary and fiscal policy, both of which are pursuing a dangerous policy of "going slow" in the recovery's early phases.

Monetary policy should act to achieve low real interest rates early in 1983. The Federal Reserve has now rightly abandoned the monetary targets it tentatively had set for 1983, in the implicit recognition that those targets were incompatible with economic recovery. But the thrust of monetary policy remains that of inching interest rates down, in the hope that adequate recovery will take hold. Monetary policy should instead set about to create the conditions for more rapid economic growth in 1983 and 1984.

Fiscal policy should provide short-term stimulus in two highly efficient ways: by meeting the needs of low-income people and the unemployed, and by supporting the provision of a significant number of useful jobs as rapidly as possible. Over the longer term, fiscal policy should have two objectives: to cut the deficits and so help restore the long-term capital markets, and to assume the rule of fairness which should be the hallmark of the American system of taxation.

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[2] "Productivity and Inflation," a study prepared for the use of the Joint Economic Committee, April 24, 1980.

HUMPHREY-HAWKINS AND THE PRESIDENT'S ECONOMIC REPORT

The Full Employment and Balanded Growth Act of 1978 (Humphrey-Hawkins Act) established national goals of full employment and price stability, and set out guidelines for the development of economic policy in pursuit of these goals. Under the Act, the President is directed to establish short-term goals each year, whose attainment is consistent with progress toward full employment and price stability. The goals should then serve as anchors for the design of short-term economic policy, and as beacons to warn when economic policy is not meeting its objectives and should be changed.

Since the enactment of Humphrey-Hawkins in 1978, two Administrations have misconstrued the provisions relating to short-term economic goals, in particular by specifying "forecasts," for the attainment of which the Administration does not assume responsibility, instead of the "goals" required by law. This procedure needs to be changed, as the experience of the present Administration in 1982 demonstrates.

In last year's Economic Report, the Administration made the following forecast: "The combination of growth-oriented fiscal policy and anti-inflationary monetary policy should mean substaintial progress toward the economic goals embodied in the Full Employment and Balanced Growth Act of 1978." Specifically, unemployment was forecast to fall from an average level of 8.9 percent in 1982 to 7.9 percent in 1983.

Obviously, this has not happened. Unemployment is now expected to average 10.7 percent in 1983, and other indicators of economic performance except for inflation, will also fall far short of the levels forecast for them a year ago. Such a divergence of performance from objectives should be followed by changes in policy adequate to restore progress toward the original objective.

The Administration forecasts for economic growth in 1983 are far below the economy's noninflationary potential. Different policies are clearly available which would bring about a higher rate of growth without renewed inflation. Under these circumstances, the Full Employment and Balanced Growth Act of 1978 requires that policy be changed to bring about more rapid growth and a more rapid reduction in unemployment.

MONETARY POLICY IN 1983—RECOVERY

From October 1979 through July 1982, with a brief exception in the summer and fall of 1980, monetary policy was conducted to fight inflation. No other objective influenced the course of monetary policy during this period. Two recessions have resulted, one in early 1980, and another which began in July of 1981 and continues to this day.

It was Federal Reserve policy through the first half of 1982 to continue strong monetary restraint despite the recession. As late as

May 18, 1982, the Federal Open Market Committee "renewed the short-run objectives (from expansion of M1) established in late March," which objectives had been intended at the time to "permit only modest growth of M1."

In July 1982, the Federal Reserve changed policy. The growth of M1 resumed at a rapid rate, and interest rates, which had been declining irregularly since the fall of 1981, began a rapid decline beginning in July of 1982. By its meeting of October 5, 1982, the FOMC had abandoned efforts to target narrow money. The FOMC's endorsement of more rapid money and credit expansion was repeated in November and in December.

In February of 1983, the Federal Reserve presented monetary targets for 1983 to Congress as required by the Humphrey-Hawkins Act. These targets reaffirm the Federal Reserve's retreat from monetarism in 1983.

The target for M1 has been widened, and its upper limit, 8 percent, is 2.5 points higher than the tentative limit for M1 in 1983 of 5.5 percent which was advanced last July. Moreover, the base from which the new M1 limit has been calculated—the level of M1 in the fourth quarter of 1982—was far higher than foreseen last July. Combining the higher range and the higher base, it is possible for M1 growth in 1983 to be considerably higher than would have been possible under the tentative targets set six months ago.

The Federal Reserve has also eased its targets for the growth of M2. The base for M2 growth in 1983, to which the 1983 target range of 7-10 percent applies, has been shifted forward to the level of M2 which will be achieved in February and March of this year. The Federal Reserve has thus given itself leeway to accommodate the full liquidity requirements of the economy in the first quarter of 1983, including all of the demand for Super NOW accounts currently flooding into M2. This flexibility means an effective target for M2 in 1983 of up to 15 percent growth above the fourth quarter of 1982, or more if M2 growth continues to be rapid in the next month.

The Federal Reserve's abandonment of monetarism is a welcome recognition of the error in the monetary policy prescription of the Reagan Administration, set forth in the Economic Recovery Program of February 18, 1981, which called for steady deceleration in money growth over a period of years, irrespective of economic conditions. This Committee warned at the time, in our 1981 Report, that a too rigid approach to monetary targeting would not work. The Federal Reserve has now acknowledged, by its actions since July of 1982, that our position was correct.

Simply put, the Federal Reserve miscalculated the costs of rigid monetarism in 1981 and 1982. In its report to Congress under the Humphrey-Hawkins Act in July 1981, this miscalculation is spelled out: the individual members of the Federal Open Market Committee estimated that unemployment in 1982 would average 7¾ percent, with the most pessimistic estimate being 8½ percent. As late as July 1982, the Federal Open Market Committee predicted that "an upturn in economic activity was highly likely in the second half of 1982." No one on the FOMC foresaw that, in fact, a sharp drop in real GNP would occur during that period.

In early 1982, a bipartisan coalition introduced language into the First Budget Resolution, on this Committee's recommendation, which urged the Federal Reserve to reevaluate its monetary targets. In the Continuing Resolution enacted in December, Congress directed that the Federal Reserve "continue to take such actions as are necessary to achieve and maintain a level of interest rates low enough to generate significant economic growth and thereby reduce the current intolerable level of unemployment." These measures undoubtedly had a positive effect on the conduct of monetary policy in 1982 and 1983.

We support the decisions of the Federal Reserve in July 1982 and February of 1983 to relax its monetary targets and to support economic recovery.[3] Monetary policy in 1983 should move to assure that strong economic recovery does occur, and monetary policy in 1984 should sustain that recovery at a rapid rate of growth.

Recommendation No. 2

The Federal Reserve should ease money and credit to achieve low real interest rates early in 1983, and should sustain such rates through 1984.

Interest rates have fallen sharply since the peak levels of 1981. The prime rate averaged over 20 percent in the summer and fall of 1981, it now stands at 11.0 percent. This is a welcome reduction, and accounts for the revival of housing and automobile sales in 1982.

Real interest rates, however, have fallen less than nominal interest rates, and remain much too high. When the prime rate stood at 20.5 percent, the inflation rate was approximately 10.5 percent, and the real rate of interest stood at the historic level of 10 percent. Now the prime rate has declined to 10.5 percent, and inflation to about 4 percent from levels a year ago. This represents a decline in real interest rates to about 7 percent. It may be that expectations of inflation have not fallen as much as inflation, and this is delaying the downward adjustment of nominal rates. However, a substantial further reduction in interest rates is called for at the present time.

Recommendation No. 34

Better coordination of monetary and fiscal policies should be achieved through the budget process. The Federal Open Market Committee's official projections for growth, inflation, and employment should be made consistent with the economic assumptions of the budget resolution.

A major weakness of budget and economic policy planning in recent years has been failure to integrate monetary policy into the budget process. If the monetary and fiscal authorities are operating on the basis of economic assumptions and goals which conflict with those of Congress, then congressional forecasts of the budget deficit are likely to be in error and the budget process itself is impaired.

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[3] Representative Hawkins states: "While I support the shift away from rigid monetarism which the Federal Reserve has maintained since 1979, and which greatly contributed to two recessions, it is not entirely clear to me that they have indeed stated a change in position nor have they wholeheartedly endorsed a different monetary policy conducive to real economic growth."

Coordination of monetary and fiscal policies has been made difficult by the failure of the Federal Reserve to provide Congress with a forecast of real economic growth, inflation, and employment which it believes to be consistent with the monetary and credit targets established under the Full Employment and Balanced Growth Act of 1978. Instead, the Federal Reserve provided Congress with a wide "range of views" of the individual members of the Federal Open Market Committee, which provided no basis for relating the Federal Reserve's monetary targets to the final economic objectives.

As a result of discussions with this Committee, the Federal Reserve has now changed its practice. The February 1983 Report to Congress under the Humphrey-Hawkins Act provides, for the first time, the "central tendency" of the Open Market Committee's members' views on growth, inflation, and unemployment. This "central tendency" is tantamount to an official Federal Reserve forecast of the expected consequences of monetary policy. A summary of the forecast is given in Table II.

TABLE II.—FEDERAL RESERVE OPEN MARKET COMMITTEE ECONOMIC FORECAST FOR 1983

[Midpoints of Ranges]

	FOMC	Administration	CBO
Changes, 4th quarter to 4th quarter, percent:			
Nominal GNP	8.5	8.8	8.9
Real GNP	4.0	3.1	4.0
GNP deflator	4.5	5.6	4.7
Average level in the 4th quarter, percent: Unemployment rate	10.15	10.4	(1)

[1] Not available.

Source: Federal Reserve Board.

Now that the Federal Reserve has agreed to supply to Congress the economic forecast on which monetary policy is based, it is possible to proceed to the next step: integration of the economic assumptions underlying monetary policy with those underlying the Budget. The logical way to do this is through the First Concurrent Budget Resolution, as Congress recognized in 1982 when it included language on monetary policy in that Resolution.

In preparing the First Concurrent Budget Resolution for 1983, the Budget Committees should seek common ground on economic forecasts with the Federal Reserve, in consultation with this Committee and with the Banking Committees of the House and Senate. Once such common ground has been achieved, language can be included in the Budget Resolution which makes achievement of the economic goals assumed therein the policy of the Federal Reserve.

FISCAL POLICY IN 1983—RELIEF AND REFORM

Recommendation No. 4

Congress should authorize and fund a significant jobs program.

Of the 11.4 million people who were unemployed in January of 1983, 23.4 percent, or nearly 3 million people, had been out of work for over 27 weeks. That is a record proportion, and can be compared with 10.7 percent of a far smaller number of total unemployed in the 1980 recession.

Many of the long-term unemployed have lost jobs that will never return. Many live in regions which have fallen into a long-standing state of depression. These workers can expect, at best, only slow reabsorption into the private sector as the economy recovers.

And the number of long-term unemployed will rise as total unemployment remains high. Under the Administration's forecast, total unemployment will remain above 10 percent on an annual average basis until 1985. While the policies we advocate in this Report would bring unemployment down more rapidly, they would still leave hunderds of thousands of the long-term unemployed without job offers in the private economy until late in business cycle upturn.

Under these circumstances, government should act to provide jobs to the long-term unemployed.

The program should be targeted on areas of high unemployment, and it should provide useful work in maintaining, repairing, and rehabilitating public facilities and essential public services. Hiring should be nondiscriminatory, with priority to the long-term unemployed, for a period of one year's employment, and at an average cost per job below $15,000. The program should be designed to respond quickly to changing conditions in the labor market.

The design of a jobs program is necessarily a compromise between the need to hire people quickly, and the desire to employ them in their most productive uses. However, in a deep recession, there is no shortage of useful work to be done. the priority should be to design programs which provide a range of jobs which require relatively little capital equipment, and which provide opportunities at relatively modest wages to workers with varying skills. Repair of public facilities and improved delivery of public services should both be permitted work categories under this progam.

Examples of labor-entensive, relatively small-scale projects include rehabilitation of public buildings; bridge painting and repair; maintenance of roads, mass transit, and traffic control systems; maintenance of water and sanitation systems; and improved drainage in flood-prone areas. Useful service employment can be created in the areas of public health, safety, education, and child care.

As studies of programs operated during the 1970's have shown, jobholders in such programs do benefit from the work experience. Especially for low-income participants, the programs resulted in future gains in employment and earnings. Equally important, the country benefits from the work that these men and women can do, in a time when the private economy would not be able to offer them productive private-sector jobs.

In order that jobs may be created quickly, state and local governments should be responsible for identifying areas where work is needed and programs can be organized promptly. Cost-sharing requirements between Federal, state, and local governments should be encouraged as needed and appropriate to keep the Federal budget cost of this program within desirable limits.

Recommendation No. 5

Congress should provide additional support this year for food, fuel, housing, and health care to low-income people.

The Federal Government has a responsibility to see that emergency needs for food, shelter, fuel, and health care are met. Additional resources should be provided to states and local communities, and to expand the capacity of private charitable organizations to respond to the rising demand for their services.

There are four specific areas in which Federal assistance can be directed promptly to those most in need.

Distribution of surplus food.

The temporary provision of surplus housing, for example on military bases.

Authorization of emergency home foreclosure relief, in the form of assistance to the long-term unemployed in imminent danger of mortgage foreclosure or, in the case of renters, eviction.

Measures to extend health insurance coverage to unemployed persons who have lost their own coverage. This is particularly urgent with respect to maternity and infant care.

Prompt action on such measures does not remove the need to strengthen the major income security programs. Many Americans now in need of aid were never eligible for unemployment insurance, public assistance, or other support programs that could normally have helped them through hard times. Others would have been eligible under the law in effect before 1981, but became ineligible just at the time they became needy. Congress should assure that eligibility for food stamps, AFDC, and Medicaid for low-income working people and the unemployed are not unduly restrictive.

Many of the cuts in means-tested programs in 1981 and 1982 have affected low-income working people who had previously relied on public assistance programs to supplement their incomes, their diets, and to provide health care which otherwise they could not afford. For example, in 1981, all families with incomes above $12,000 were excluded from the food stamp program, irrespective of family size. AFDC benefit reduction rates have been altered, so as to increase the benefit penalty associated with each dollar of outside earnings. Changes in the "income disregard" associated with work-related expenses (clothes, travel, tools, equipment, child care, etc.) have disqualified for AFDC needy families with heavy expenditures in these areas. In many of these cases, disqualification for AFDC has also meant a loss of Medicaid benefits.

The standard of living of low-income people has been eroded by these changes, as has the ability of the system of public assistance to respond to the additional needs generated by the recession. In 1981, the proportion of persons living in poverty increased by the largest amount since 1967, from 13.2 to 14.0 percent. That represents an increase of 2.2 million persons, for a total of 31.8 million.[4] No doubt in 1982 the rate of poverty rose even further.

For many programs, expectations that lost Federal revenues would be replaced by state, local, and/or nonprofit organizations' revenues have not materialized. Most state and local governments have not replaced lost Federal aid, partly because the fiscal effects of the recession have impaired their ability to do so. Because nonprofit organizations are so dependent on public support, reductions in Federal aid are forcing them to curtail activities also.

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[4] Census Bureau, Current Population Reports, Series P-60 Number 134.

Even if the recession ends in the next few months, its effects, and the effects of program cuts, on low-income people will continue to be felt. There is thus a compelling case for additional support of food, fuel, housing, and health care to low-income people in 1983. Part should take the form of funding for relief that can be dispensed rapidly under existing law. But there is also no substitute for a truly effective safety net. There is no case for further reductions in means-tested benefit programs at this time.

Recommendation No. 6

The Federal Supplemental Compensation program should be extended to provide 10 additional weeks of coverage to those who have exhausted benefits, and to provide the current level of coverage for workers who become newly eligible over the next nine months. Proposals to cut eligibility for FSC by increasing the number of weeks worked in the base period should be rejected. Consideration should be given to the use of a national unemployment rate trigger as steps to reduce the Federal deficit take effect.

Congress should suspend changes in the Extended Benefit program that restrict availability of the program in certain states and extend the two-year grace period on repayment of Federal loans to state unemployment insurance programs.[5]

Six and one-half million persons—about half of the unemployed—are currently drawing unemployment insurance benefits. This compares to 70 percent of the jobless at the height of the 1974–1975 recession and to an average of 60 percent for all seven previous postwar recessions. Until passage of the Federal Supplemental Compensation program in September 1982, only about 40 percent of those unemployed during this recession qualified for any jobless benefits.

Since 1981, most states have responded to cost pressures by restricting eligibility for the regular 26-week program. Federal law changes have also limited the ability of states to qualify for the Extended Benefits program, which provides an additional 13 weeks of benefits. Moreover, the rapid sequence of the 1980 and 1981 recessions prevented many of the jobless from working long enough to establish or reestablish their eligibility for unemployment insurance. And the numbers of jobless persons exhausting their benefits keeps growing as weak labor markets persist.

The Federal Supplemental Compensation program now provides a third tier of benefits, adding either 8, 10, 12, 14, or 16 weeks to whatever regular and extended benefits are available. Since the length of supplemental benefits depends upon a state's unemployment rate, most states can offer a total of 40 weeks of benefits. In several states with high unemployment, the combination of regular, extended, and supplemental benefits permits 55 weeks of coverage. Federal supplemental benefits should be extended. An additional 10 weeks of benefits should be provided to those who have exhausted their unemployment benefits, with current levels of coverage available to newly eligible workers. Consideration should be given to eventual use of a national unemployment rate trigger.

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[5] Senator Bentsen agrees that Congress could consider the suspension of changes in the Extended Benefit program, and extending the two-year grace period on repayment of Federal loans to state unemployment insurance programs, as the budget deficit is brought under control.

To reduce costs, the Administration's Fiscal 1984 budget would make it harder to qualify for the FSC program by requiring recipients to have worked 30 rather than 20 weeks in the base period used to determine eligibility. This change would deny benefits to an estimated 300,000 long-term unemployed persons and should be rejected.

Meanwhile, because of restrictions enacted in 1981, the second tier of the system—the Extended Benefits program—is irrelevant for many states. Currently, 24 states and Puerto Rico qualify for extended benefits. Four states with double-digit unemployment rates are not eligible. The principal reasons are higher state trigger levels, which took effect in September 1982, and a change in the method of calculating these rates. Because persons receiving extended benefits are now excluded in the computation of the trigger rates, several states with severe unemployment—such as Michigan and Maryland—lost eligibility for extended benefits at times last year. If these changes were suspended, a total of 34 states would be able to offer extended benefits. If the former national trigger for the program still applied, extended benefits would be available in all states.

Even with lower eligibility rates, the cost of unemployment insurance claims in this recession has risen. Double-digit unemployment brought expenditures on unemployment insurance close to $22 billion in 1982, up from $18 billion in 1981 and $16.5 billion in 1980. The states' share, which finances the regular 26-week program and one-half of the cost of Extended Benefits, rose from $13.5 billion in 1980 to $20.3 billion in 1982.

Many of the hardest hit states, reluctant to raise payroll taxes on employers or cut benefits to the jobless any further, have borrowed heavily from the Federal Government to meet their program obligations. As of January 31, 1983, 23 states plus District of Columbia, Puerto Rico, and the Virgin Islands had accumulated debts of more than $11.7 billion. At least 35 states are expected to have outstanding loans in 1983.

The 1981 budget reconcilation legislation changed the rules on borrowing by states whose revenues for unemployment insurance have run short. Interest charges—currently 10 percent—have been applied to states taking out loans after April 1982. After a two-year grace period, states with outstanding loans will see employer payroll taxes go up unless their programs meet certain new standards for solvency.

These requirements are ill timed in the context of the current recession. States with high levels of unemployment—those most likely to incur the debts—are least able to afford the penalty of higher payroll taxes. Nationwide, employers already face an increase in unemployment insurance payroll taxes of $1.4 billion in 1983. Extending the two-year grace period would spare states with high unemployment from the choice of cutting program costs to deter the tax penalty or risking new losses of industry and jobs.

Recommendation No. 7

Congress should provide fiscal assistance to state and local governments this year to avert sharp cuts in public services and regressive tax increases. Such assistance should be phased out as the economy recovers. No counterproductive cuts in programs benefiting state and local governments should be made this year.

For the state and local sectors, 1981 and 1982 were years of transition. New federalism took a major leap forward and the growth in Federal aid was reversed. At the same time, the national economy was mired in a recession and interest rates were high. Taken together, these factors had far-reaching implications for state and local governments.

In October 1982, the Committee released its annual survey on the fiscal condition of cities. Our 1981 survey had shown that the number of cities running operating deficits was large. According to our latest report, five more cities were added to the list, bringing the proportion of cities with operating deficits to 40 percent. Cities were projecting virtually no growth in revenues in 1982. For cities of all sizes, revenues were expected to increase by 1.3 percent, a reduction of approximately 6 percent in real terms. Expenditures were projected to increase by an average of 7.8 percent. As a result, as many as 60 percent of the respondents may have incurred a current deficit in 1982 unless expenditures were reduced or revenues raised. The survey also found that the buffer generally provided by carryover balances has continued to decrease, thereby reducing the margin for fiscal error. Finally, our respondents indicated that city work forces have once again declined and were expected to decline further in 1982.

According to a survey of 41 states conducted by the National Governors Association (NGA) and the National Association of State Budget Officers (NASBO), these states expected to end FY 1982 with a combine surplus of $1.6 billon, and FY 1983 with a $2.0 billion deficit. This compares to a surplus of $11.8 billion as recently as 1980. Nine states—California, Colorado, New Hampshire, New Jersey, New York, Pennsylvania, Vermont, Virginia, and Wisconsin—are currently projecting budget deficits for the end of the fiscal year.

Only six months ago, FY 1983 revenues were expected to be $8 billion higher than current projections and expenditures were projected to exceed current estimates by $5 billion. NGA concludes, "the Report quantifies the devastating impact the recession has had on state revenues. As bleak as these totals are, the fiscal situation in the states is probably worse than portrayed here."[6]

Because all states except Vermont are prohibited from running deficits, discretionary actions to reduce expenditures and increase revenues have been implemented. The results are tax rate hikes, program reductions, and employment layoffs. State tax increases in 1982 were the largest in more than a decade. Four states raised their income taxes; five increased their sales taxes; and nearly half of the states have increased other taxes or fees. In addition, budgetary pressures have forced 26 states to cut back their 1982 and 1983 budgets after those budgets had already been proposed or enacted; 32 states imposed either across-the-board or selective spending cuts—or both—for fiscal year 1982 or 1983; 33 imposed hiring limitations; 18 laid off employees; and eight initiated furloughs.

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[6] *National Governors Association News Release,* January 7, 1983.

High interest rates and the severity of the national recession have exacerbated state and local fiscal problems. According to the Bond Buyer Index, interest rates on municipal bonds in 1982 average 11.6 percent. Although recently interest rates have been declining, at 9.5 percent they still outpace the Bond Buyer Index for the 1970's, which average only 6.95 percent. Thus, for $75 billion in long-term borrowing in 1982, state and local governments are committed to paying over $3 billion more in interest costs over the course of the loans than they would have if the same level of borrowing occurred in the 1970's.

What is more, unemployment has reduced state and local revenues, while increasing the need for additional social services. In particular, cyclically sensitive taxes, such as those on sales and income which are buoyed during inflationary periods tend to decline the most during recessions. Due to the seriousness of the recession, property tax revenues, which have grown rapidly in recent years, are also tapering off.

The Community Development Block Grant program provides one means that additional funds could be provided to state and local governments to relieve distress and at the same time lessen fiscal pressure. At least $1 billion in additional CDBG funds could be made available and used effectively this year. The State and Local Fiscal Assistance Act (general revenue sharing could also be made into a vehicle for a temporary increase in general fiscal assistance to local governments.

Recommendation No. 8

The July 1, 1983, 10 percent personal income tax reduction should be capped at a maximum benefit of $700 per taxpayer, preserving the full benefit of the cut for all taxpayers earning less than $46,500.

Steps are needed this year to establish that Congress is prepared and determined to cut the budget deficit in future years. One step, which would have no adverse effect on recovery this year, would be to place a $700 cap on the benefit received from the July 1, 1983, 10 percent personal income tax reduction.

A cap on the July 1, 1983, tax reduction would raise $1 billion in fiscal year 1983, $5 billion in fiscal year 1984, $7 billion in fiscal year 1985, and progressively larger sums thereafter. Over a three- to five-year period, it would more than completely pay back the cost of a significant jobs program. Alternatively, such a cap would more than offset the additional cost of needed relief programs in 1983 and 1984. A cap would only affect those taxpayers currently earning over $46,500 per year, who have received more benefit from the tax reductions already put into effect in 1981 and 1982. All other taxpayers would receive the full 10 percent reduction in their taxes on July 1.

Such a cap, finally, would be good for the economy. In the current state of the economy, the urgent priority is for additional spending power to set the recovery moving; a cap on the third year of Kemp-Roth would promote this objective, by helping to lower interest rates, reverse expectations of high future deficits, and provide resources that are needed to bring about an end to the recession this year.

FISCAL POLICY IN 1984–86—RECONSTRUCTION

Recommendation No. 9:

Congress should put in place in 1983 a fair and effective deficit reduction program for Fiscal Years 1984–1986.

To sustain the recovery beyond this year, the budget deficits from Fiscal 1984 through 1988 must be reduced well below the levels currently projected. The growth in spending projected through 1988 must be reduced as part of this effort, but no adequate cut can be made in projected deficits unless we also consider revenues.

The current situation is unprecedented. Deficits projected for 1984 and beyond actually increase, even if the economy recovers from the recession. The Federal deficit would rise to almost $300 billion by Fiscal 1988, even under optimistic assumptions about the performance of the economy between now and then.

In the past, Federal deficits have fallen, not risen, during recovery periods.

During a recovery, the deficit should decline, Tax receipts normally rise as people go back to work, businesses become profitable, and incomes grow, while safety net expenditures normally decline. A gradual reduction in the deficit during recovery also serves to keep the economy from expanding too quickly and thus reduces inflationary pressures.

Deficits of the size projected for 1984 through 1988 would tend to induce another cycle of inflation and recession if the economy recovers as projected. Greater long-term stimulus is likely to bring about a more rapid return of inflation. Should this actually be our fiscal policy, the Federal Reserve could come under pressure to tighten money and create another recession before the economy has fully recovered from this one.

Recommendation No. 10:

Personal income tax indexing should be repealed.[7]

The base of both the personal income tax and of the corporate income tax should be broadened, with special emphasis on the elimination of tax expenditures which are obsolete, inefficient, or particularly regressive, and on reform of depreciation schedules to improve the neutrality of the tax code with respect to different classes of investment.

We oppose proposals for broad-based regressive consumption taxes.

Personal income tax indexing should be repealed. With inflation for 1984 and 1985 projected at 4 to 5 percent, the purpose of indexing—to protect taxpayers from bracket creep—is no longer compelling. But the projected deficits for 1985 and beyond are a compelling argument in favor of the repeal of indexing. From 1985 through 1988, the Administration projects a cumulative deficit of $601 billion. Repeal of indexing would reduce the deficit by $90 billion without imposing a new tax on anyone.

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[7] Senator Bentsen feels that, in light of the large budget deficit, personal income tax indexing should be deferred.

Indexing of income taxes would be bad economic policy even under a better current outlook for the deficit. In periods of inflation, indexing would inject economic stimulus by cutting tax rates, at just the time when good economic policy would call for restraint. Under such circumstances—accelerating inflation, rising deficits—interest rates would be certain to rise. Thus, indexing would actively promote the vicious sequence of inflation and recession which economic policy ought to be devoted to defeating.

Broadening the tax base by eliminating loopholes will help reduce the deficit while improving the fairness of the tax code. The base of the personal income tax code has become riddled with exemptions and deductions. While some serve a useful purpose, channeling private spending into activities that would otherwise be underfunded, all complicate the tax statutes, serve to erode the tax base, and in their aggregate contribute to a lack of public confidence in the tax system.

A recent study prepared for the Joint Economic Committee by the Treasury Department found that the top 4.4 percent of taxpayers in 1981—those making $50,000 or more—received a more that proportionate share of the benefits of 13 out of 33 tax expenditures examined.[8] The study found some major tax expenditures to be highly regressive, such as the exclusion of interest on state and local bonds, with 94.1 percent of the benefits going to the most affluent taxpayers, and the capital gains exclusion, 63.5 percent of which goes to the wealthiest taxpayers.

Selective loophole closing will improve the progressivity of effective tax rates, and make possible further modification of the marginal rate structure. In its purest form, with no deductions of exemptions, a flat rate tax would entail a massive shift of the tax burden from upper-income to middle-income taxpayers. But a lower marginal rate structure that incorporated some of the more progressive deductions and exemptions can be designed to expand the tax base, and still make the overall tax system more progressive and more equitable.

At present, virtually all of the measures under consideration to reduce the deficits for 1984 and beyond would increase the tax burden on individuals. Corporations should pay their fair share of new revenues.

Such measures should aim to improve the neutrality of the tax system with respect to types of business investment. The Accelerated Cost Recovery System, enacted in 1981 to reduce taxes on new investment, has acted to subsidize short-lived assets, such as automobiles and machinery, at the expense of long-lived assets, such as factories and structures. This non-neutrality of the business tax system cuts efficiency and wastes resources. This provision of the corporate income tax needs to be revised as the economy recovers.

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[8] Letter and tables transmitted to Chairman Henry S. Reuss on September 28, 1982, by John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy.

Finally, we oppose proposals for regressive tax increases on consumption, such as a value-added tax or a national sales tax. Such a tax would fall unfairly on moderate and lower income households who devote a larger percentage of their incomes to consumption, at a time when such households are already suffering a considerable increase in the proportion of the total tax burden which they bear. A VAT or national sales tax would also be inflationary, since it would be added directly to the price of goods sold at retail. And such a tax would greatly increase the burden of paperwork, especially on small businesses who would have to absorb the additional costs out of their already recession-diminished profits.

Recommendation No. 11:

Military spending increases should be slowed for the immediate future by more prudent decisions with respect to weapons systems and to procurement, rather than through cuts which will affect the recruitment and retention of qualified military personnel or their combat readiness.

The defense budget is at the core of government's commitment to protect the Nation in a perilous world. However, there can be no serious effort to hold down government spending if the defense budget is not addressed. The large increases planned for defense are disturbing from an economic perspective because our experience has been that too rapid military buildups lead to waste and inefficiency.

There are additional problems. Under present circumstances, the rapid planned military buildup is contributing significantly to the budget deficits. Further, the higher level of defense spending will probably result in some crowding out of private investment.

The present military buildup is a consequence of spending increases proposed by the Administrations of former President Carter and President Reagan and is the largest buildup in our peacetime history. The defense budget, not including the military component of the space program and other defense-related activities, is scheduled to grow in terms of budget authority from $214 billion in fiscal year 1982 to $445 billion in fiscal year 1988.

Murray Weidenbaum, former Chairman of the Council of Economic Advisers, testified before this Committee on December 15, 1982, that, toward the middle of the decade, when significant economic growth may coincide with the peak of the military buildup, three results of the buildup can be anticipated: the substantial transfer of resources in the durable goods sector to defense production may increase relative prices for the Defense Department and private purchasers; increased demand may produce delays in the delivery of military goods; and some crowding out of private investment may occur.

Primarily, the proposed defense increases are for procurement of weapons and equipment. When calculated as a percentage of the overall manufacturing base of the national economy, these increases represent an upward surge. There is reason for concern about the capacity of the defense industries to make deliveries on schedule and about the ability of the Defense Department to manage its procurement programs. If deliveries cannot be made on time, bottleneck problems and cost increases will ensue, with possible inflationary effects on the general economy.

There is presently so much excess capacity in American industry that capacity problems are unlikely for the next year or two. However, the persistence of cost problems in defense production has been widely noted. The latest defense deflator statistics show a slowdown of inflation in the defense sector which is less than has occurred in the rest of the economy.

The findings of recent studies of the management of defense procurement are equally disturbing. A study issued by the Committee last year noted that, unless the trend of cost overruns is reversed, the cycle of higher unit costs leading to increased budgets and increased budgets contributing to higher unit costs will be perpetuated.[9] Two studies performed in the Defense Department, portions of which were made available to the press, conclude that cost estimates of major weapons programs continue to be unrealistically optimistic: "actual procurement costs usually exceed the planning estimates."[10] Studies by the Heritage Foundation and others demonstrate the relative ineffectiveness so far of efforts to control cost growth in defense procurement.[11]

Defense spending could crowd our private investment whether or not there are capacity problems if, as seems likely, monetary policy does not accommodate the increased defense spending or the potentially induced increase in nominal and real GNP. In his testimony before this Committee, Otto Eckstein stated that, under this condition, defense spending crowds out private spending even in a period of general slack unless taxes are increased. Dr. Eckstein said, "In the current circumstance, it must be recognized that we have chosen the path of a massive increase in defense spending without asking the public to pay for it." The defense buildup, he continued, combined with the tax cuts constitute "the origin of the enormous deficit problem and forces us to consider the question to what extent the growth of aggregate supply, i.e., the long-run growth of the economic potential of the country, will be damaged by a defense boom that is not paid for." To avoid this consequence, major tax increases would be necessary to adequately finance the defense buildup.

A slowdown in the rate of defense increases can produce significant budgetary savings. The defense spending increases proposed by the Administration will average about 7 percent real annual growth over the next five years. If annual growth of defense budget authority is trimmed to, say, 5 percent, the five-year savings would be approximately $129 billion, or about $26 billion per year. With a 3 percent growth rate, the savings in budgetary authority would be about $228 billion for the five years, or $46 billion annually.

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[9] "The Defense Buildup and the Economy," p. 29, a staff study prepared for the Subcommittee on Economic Goals and Intergovernmental Policy.

[10] Quoted in the Wall Street Journal, Dec. 7, 1982.

[11] "Agenda '83," edited by Richard Holwill (Heritage Foundation, 1983).

Recommendation No. 12:

Entitlements programs should not be exempt from review as part of the broader effort to reduce budget deficits in future years.

Entitlements are at the core of government's commitment to the well-being of the elderly, the sick, and the handicapped and disabled. There will always be a significant need for the services that entitlement programs provide and for the rights that they convey: the right to reasonable nutrition, health care, a retirement income, and to basic income support for those who cannot support themselves.

In the present recession, entitlement programs are hard pressed. The demand for their services has risen, and at the same time many currently ineligible people are in need of assistance. Now is a time when basic entitlement programs should be protected, not demolished.

The first priority in reducing the budget deficit should be reduced growth in military spending and improved revenues. At the same time, no serious effort to reduce the budget deficit in future years can ignore certain aspects of the entitlement programs. There remains room for streamlined operation of these programs which will not undermine the well-being of those who are necessarily dependent on them.

Entitlement programs have been plagued in the past by faulty adjustments for rises in the cost of living, which have either overstated or understated the actual effect of inflation on the recipient group. It is probably impossible to predict in advance just how any particular indexing mechanism might distort cost-of-living adjustments. Congress should therefore retain the flexibility to adjust future cost-of-living payments to compensate for unintended underpayments or overpayments on a case-by-case basis, if they occur.

Second, health care costs continue to rise at double-digit rates despite the recession. It is quite apparent that only a major reform in the finance, delivery, and pricing of health care is likely to bring this aspect of the entitlement sector under control. Congress should be prepared to implement health care cost containment well before the projected financial difficulties of the Medicare trust fund are upon us.

INTERNATIONAL ECONOMIC POLICY

The problems of our domestic economy—unemployment, stagnation, high real interest rates—are now more closely linked to the fate of the world economy than ever before. Today, almost every nation is trying to limit its imports and boost its exports—while at the same time continuing with domestic austerity to fight inflation or, in the case of LDC's, to conserve scarce foreign exchange. This is a formula for worldwide depression.

Economic recovery abroad depends on an early and strong economic recovery in the United States. At the same time, sustained economic recovery in the United States will require a revival in the rest of the world. U.S. policy must therefore be designed to foster both domestic and international recovery as close to each other in time as possible.

Recommendation No. 13

The overvaluation of the U.S. dollar must be ended.

The principal means for correcting the overvaluation of the dollar is through lower U.S. interest rates. The overvalued dollar has cost the U.S. economy over one million jobs. It has contributed significantly to the rise in protectionist pressures in this country.

During all previous postwar recessions, the U.S. trade balance improved, because demand for imports slackened along with demand for domestic goods. The reason for the deterioration this time is the overvalued dollar, which has made U.S. goods less competitive. Estimates of the relative loss of competitiveness in 1982 alone range from 20 to 30 percent.

The high dollar also has worsened the debt crisis and inflation for the oil-dependent developing countries. Global oil prices are denominated in dollars. The currencies of developing countries have depreciated against the dollar so much that the price of imported oil is almost twice as high for them as it is for the United States. Thus, their balance-of-payments positions, already strained by high interest payments on their debt and slackened demand for their exports, have been further eroded.

When, in 1981, the dollar began appreciating strongly against the other major currencies, the principal reason was the sizable interest rate differential between the United States and Germany and Japan. Interest rates here began dropping during the late spring, thus narrowing the interest rate differential. In November, the dollar began to fall relative to the Japanese yen and the German mark. The decline against the yen has been striking. This trend is most welcome, and will, we hope, continue. Further progress in the realignment of our currency depends on further progress in getting interest rates down.

Recommendation No. 14

The United States Government must seek to assure the proper enforcement of existing trade laws and seek elimination of foreign trade barriers which limit our exports.

As the fourth year of the world recession begins, trading partners are eyeing each other with increased hostility. The GATT Ministerial Meeting failed to alter the drift towards protection.

The present recession poses the severest test of open trade since the Great Depression. With exports comprising a substantial share of each nation's production, more and more jobs depend upon them, and the use of direct or indirect government export subsidies abroad has grown sharply. This Nation should take the lead in rebuilding a multilateral trade system free of such subsidies. As part of that process, we must be willing to counter export subsidies on a case-by-case basis, as we did in the recent sale of one million metric tons of wheat flour to Egypt. And, Congress should meet the Administration's request for $2.67 billion in standby funds to enforce the 22-nation agreement signed last year limiting such government export subsidies. Since the world has profited so much from open trade, we should continually remind and demonstrate to our trading partners that any short-term gains for particular sectors through protection may be offset by long-term disadvantages to other sectors, and to their economies as a whole.

The traditional merits of open trade—enhanced competition at home, benefits for consumers in variety, price, and quality, and improvements in the general welfare from international specialization—are still theoretically valid. In today's competitive arena, we must be prepared to act firmly against imports which are subsidized or dumped, providing only that there has been injury to domestic producers. We should use the "escape clause" in the trade law which provides for import restraints—usually temporary and phased out over a period of years—where domestic industry has been injured, even if the imports in question are neither subsidized nor dumped. When other countries follow a similar policy, we should insist on our right to compensation.

U.S. traders have recently sought protection under Section 301 of the 1974 Trade Act as amended by the Trade Agreements Act of 1979. This reflects a concern that the GATT dispute settlement mechanisms are inadequate to protect U.S. rights. Section 301 provides the President with authority to impose restrictions against individual countries in retaliation against "unjustifiable" or "unreasonable" foreign trade practices. We cannot tolerate the creation of any disingenuous ways of excluding American exports. Ours is still the largest market, and we should be prepared to close down some of it in response to unfair trade practices.

The enlargement and fairness of trade remain our primary interests. We must avoid enacting laws which would force us to require bilateral, sectoral, or product-by-product reciprocity, but we should be prepared to pursue such policies when they serve the national interest. The relief we do provide—for those industries which qualify as most affected by import competition—should be structured to build a viable multilateral trade system.

Recommendation No. 15

Congress should support the requested increase in the lending authority of the IMF.

Global economic interdependence is illustrated nowhere so well as in the LDC foreign debt problem. As more countries find it difficult to repay their debts, the possibility of one or more defaults, the failure of several major banks, and an international financial collapse must be considered. Short of such an eventuality, it is likely that some of the debt may never be repaid. The problems experienced by the developing nations have already caused them to reduce their purchases from the United States and the West. The developing nations purchase 40 percent of the goods and services exported by the OECD countries and about the same percentage of U.S. exports. Any contraction of credit from the West to the LDC's will cause a greater reduction of Western exports and is bound to aggravate unemployment.

The total foreign debt of the LDC's reached about $640 billion in 1982, an increase of 200 percent since 1978. The heavy burden of this debt is evidenced by the fact that the interest payments alone represented between 30–45 percent of LDC exports. Commercial banks account for approximately $375 billion of the total debt.

The debt problem is due largely to circumstances beyond the control of the debtor countries. These circumstances are the rise in oil prices, higher interest rates, and the global recession. Since the oil shocks of the 1970's the costs of oil imports for the oil importing developing nations have risen from 6 percent of total import costs in 1973 to 20 percent today. The rise in interest rates caused the average interest rate on outstanding long-term debt to rise from 4.5 percent in 1973–1977 to 8.5 percent in 1981–1982. At the same time, the global recession has depressed commodity prices and made export markets in the West and elsewhere less profitable.

So far, the nations who borrowed the most are the ones having problems. Not all foreign debtors face debt payment interruptions.

The largest of those who have problems made serious economic mistakes. Poland and Brazil followed a high-growth strategy which required huge foreign loans and involved high risks. Mexico was unable to adjust to the decline of demand for oil, on which it had based its development strategy, and kept incurring large deficits. Argentina and Chile allowed their currency exchange rates to be overvalued and there, as elsewhere, debt got out of hand. The United States and other industrial nations undoubtedly made policy mistakes that led to recession, or at least failed to make the adjustments to such changes as the oil shocks that would have avoided recession. The commercial banks and the government regulatory authorities also made their share of mistakes. The difficult problem is allocating the costs of solving the problems.

The international banks and most economists agree that the IMF replenishment is intended only as a partial solution, to provide much needed immediate credit and to encourage the commercial banks, which provide most of the loans to the LDC's, to continue flows of new financing. Secretary Regan has warned the commercial banks that enabled LDC borrowers to run up dept—"some of it nonproductive and nonforeign exchange earning"—of the dangers should they attempt to reduce exposure during the adjustment process that is underway.

Whether the IMF replenishment is viewed as a stop-gap effort or part of an overall strategy, it will have no lasting effect unless there is a sustained recovery from the global recession. To restore business and consumer confidence worldwide, Secretary Regan has said, there must be "a set of economic policies in the major industrialized countries that will produce economic growth and a counter to the risks of inward-looking protectionism." The consensus is that a recovery must be led by the United Stated. The Administration should take the opportunity of the Williamsburg summit to assure our allies of our commitment to pursue strong economic growth in the United States, and to secure their cooperation in a coordinated program of global economic expansion.

An important question for Congress is whether the Administration's IMF request is made in the context of a broader economic strategy likely to bring about a strong, sustained economic recovery. If there is no recovery or only a weak one, replenishing the IMF and other recent emergency actions could prove to be first-aid measures that were too little, too late. It is possible for further debt troubles to arise this year, even if recovery gets underway, and some economists are predicting that an additional IMF replenishment might be needed in the near future.

Recommendation No. 16

Any increase in the IMF quota should be accompanied by actions to tighten oversight of foreign lending.

In recent years, an increasing share of the debt has been undertaken on market-related terms, from commercial banks, and at short maturity. These trends cause special concern. For one thing, short-term loans have been increasingly relied upon to finance long-term development projects. This posed no problem while banks were willing to rollover previous loans. Since the onset of the debt troubles, banks have become reluctant to provide rollovers.

The U.S. bank regulatory agencies should increased their ability to monitor foreign lending by U.S. banks. Information about short-term loans is inadequate, causing borrowers and lenders to underestimate potential problems. They are also difficult for governments and private organizations to monitor. The previously undisclosed large amount of commercial short-term loans caused many government officials and private specialists to be surprised by the total indebtedness of some of the countries whose problems were made public in 1982.

In an effort to develop better data, the Interagency Country Exposure Review Committee of the three U.S. bank regulatory agencies has met three times a year since the spring of 1979 to review the findings of its examiners. Countries that interrupted or were about to interrupt debt servicing were designated "classified," and others designated as "weak," "moderately strong," and "strong." The designations are, in effect, a system of credit ratings. However, there is no indication that he system has had any effect on foreign lending so far.

It is possible to correct the deficiencies in the system without creating a new government agency. First, the authority of the interagency committee can be enlarged and its monitoring of foreign lending practices increased. Second, the functions of the interagency committee can be enlarged to provide an important step towards an international clearinghouse of information about foreign lending. As a first stage, the interagency committee can collect information about foreign lending by U.S. banks and make it available to government officials in the Executive Branch and Congress, as well as to the financial community. All that would remain is for other governments to provide similar information about the foreign lending of their banks and to exchange such information with the United States and other countries.

II. TO SUSTAIN GROWTH

Recommendation No. 17

Cooperative policies to fight inflation must be developed as the economy recovers.

Inflation is in remission. The Consumer Price Index rose by only 3.9 percent for the 12-month period ending in December 1982, which is less than one-half of the inflation rate in 1981, and less than one-third of the inflation rate in 1980. Food prices, housing, and energy prices all rose much less than in previous years, and interest costs fell. Only medical costs failed to moderate during 1982, rising 11.1 percent.

For the immediate future, the inflation outlook is good. Falling oil prices in recent days will probably mean a substantial further slowdown in the CPI in the months ahead. There continue to be large agricultural stocks overhanging the market, assuring relatively stable food prices. Wage settlements will continue to be very moderate, given the depressed condition of the labor market. Rapid productivity growth in the early phases of the recovery, a standard cyclical phenomenon, will further ease pressure on prices of manufactured goods. Only the prospect of a falling dollar—otherwise desirable—might imply some increase in prices in the year ahead.

But the relief from inflation during 1982 was due almost entirely to the recession. Inflation followed a pattern which is entirely characteristic of the postwar business cycle. During the 1974–1975 recession, for example, as the unemployment rate rose from 5 to 9 percent, the inflation rate fell from 12.2 percent (in 1974) to 4.8 percent (in 1976), which is roughly comparable to the experience of the past three years.

Unhappily, recovery periods have almost always brought renewed inflation after a few years. Indeed, the experience since the early 1960's has been of progressively worse inflation in each succeeding business cycle. There is no guarantee that today's low rate of inflation, an artifact of recession, will persist once economic growth is restored. The best historical evidence suggests the reverse: inflation will return a few years after growth returns, unless strong and effective policies are implemented to stop it.

By far the best and most durable way to combat inflation is to raise the rate of productivity growth. Each additional point of productivity permits an equivalent increase in real incomes without putting any pressure on prices. The recommendations which follow in this section outline a broad program which would meet the challenge of increasing productivity, and so sustaining growth while keeping inflation at bay.

In addition, measures will be needed to prevent chronic sources of inflation in our economy from getting out of control. This can only be done effectively on a permanent basis if the principal players—business, labor, and government—are brought together at all levels, with a common purpose, and with the tools necessary to forge and implement a consensus policy against inflation. Compulsory, short-term policies implemented against the will of major economic sectors cannot, on past experience, be sustained. The Administration and Congress should take advantage of the time available while inflation remains in remission to consider and choose a strategy to prevent inflation from returning. No one should be lulled into the complacent assumption that inflation has disappeared indefinitely from our national life.

TRAINING AND JOB SERVICES

Recommendation No. 18

The newly enacted job training and dislocated worker assistance program needs increased funding.

Many workers need to equip themselves with new skills to compete for jobs when the economy does improve. Among other groups, youth and other new entrants to the labor market, the economically disadvantaged, and workers displaced from long-term jobs in contracting industries could benefit from the opportunity to improve their training or educational background. Such investments will also benefit the Nation through higher levels of productivity, employment, and output of goods and services.

Beginning in Fiscal 1984, a new job training law will take effect, replacing programs operated under the Comprehensive Employment and Training Act (CETA). State and local areas will receive funding for such services as job counseling classroom training and education, and on-the-job training. Ninety percent of program participants must be economically disadvantaged: 40 percent of the funds—excluding those reserved for summer programs—must be used for youth.

The Administration requested $1.9 billion for job training under the new Act in its FY 1984 budget. Even with the stricter focus on low-income groups, state and local programs could effectively utilize substantially higher amounts. The new law is structured to strengthen the involvement of private employers in the design and operation of training programs. This effort deserves stronger funding.

Also, the Administration has recommended $240 million for a new dislocated worker assistance program. This level should be approved to enable job search assistance, retraining, relocation assistance and supportive services for workers whose plants closed, and for other long-term unemployed. The experience with seven Federal demonstration projects and other promising state initiatives should serve to guide the design of these programs.

Recommendation No. 19

State unemployment insurance laws should be modified to encourage training and education, while avoiding measures which have a punitive effect on those unable to work.

The unemployment insurance system is currently structured to provide short-term income replacement. Without undercutting this vital function, certain revisions in unemployment insurance programs would enable workers to develop their skills and move into jobs more quickly. Such program should be designed so as to make this option available to those for whom it would be useful, while not punishing or denying unemployment insurance eligibility to those for whom retraining is not a sensible option.

Three states have amended their unemployment insurance laws to encourage sharing of available work during a downturn. Under such arrangements, workers who would otherwise be laid off but remain on the payroll for shorter hours could receive a prorated unemployment insurance benefit. Firms are induced to retain these workers because they will save on rehiring and retraining costs once business picks up. Sometimes, the worker's downtime is profitably used for retraining. In California, which enacted the first work sharing legislation four years ago, 4,485 employers and 174,000 employees have made use of the provision.

Another approach might be to establish a separate training account, financed jointly by contributions from workers and employers. Resembling an individual retirement account (IRA) in concept, these training accounts would accumulate contributions and interest while the worker is on the job, until a sufficient threshold, perhaps $6,000 per worker, is reached. A displaced worker could then use the funds from this account like a voucher, to pay for education, retraining, relocation, or related expenses. While self-financing, the account could be linked to the unemployment insurance system, by requiring workers to draw on the funds after collecting unemployment insurance for some period of time.

The Committee urges through examination of these ideas and their economic implications. While struck by the imaginativeness of the training account proposal, the Committee notes that the method of financing is equivalent to a new payroll tax on workers and employers. In view of the weak economy and already high payroll tax levels, such a tax is not advisable at this time.

Recommendation No. 20

The functions of the Employment Service should be enlarged, with greater efforts to expand use of the Service by applicants and employers. Additional resources and staff should also be provided to offices administering unemployment insurance.

The U.S. Employment Service (ES) serves as a labor-exchange for individuals seeking work and for employers with job openings. Its activities include counseling, testing, vocational guidance, and job referrals. By producing better matches between workers and jobs, an efficient system of job information and placement assistance will result in higher productivity. It can save the Nation billions of dollars by helping to shorten spells of unemployment and reduce periods of dependence on transfer payments from the government.

The new job training act includes the most significant revisions of the Employment Service Act since its passage 50 years ago. The law relieves the Enployment Service of functions like migrant and seasonal farm-workers' housing inspections, alien labor certifications, and unemployment insurance work test verifications, thereby providing a greater proportion of ES funding for its labor-exchange function. Also, the funding formula is altered to concentrate greater resources upon the training and counseling needs of hard-to-place applicants.

Computerized innovations have substantially improved the effectiveness of ES in making timely and accurate job matches. However, advanced technology must be accompanied by capable personnel service, including efforts to improve relations with employers.

Double-digit unemployment has naturally increased demand on unemployment insurance offices and branches of the Employment Service. Unemployment insurance offices have endured sharp reductions in permanent staff while the job service was recently denied a much-needed increase in personnel. As the long lines of people demonstrate, service to the public has deteriorated. Proper staffing for unemployment insurance and Employment Service offices will help to ensure better information to job seekers and speed the process of reemployment.

Recommendation No. 21

Equal employment opportunity laws should be enforced vigorously, with adequate funding for enforcement activity.

Blacks, Hispanics, and women continue to experience significant labor market disadvantages by comparison with whites and males, and it should continue to be a vigorous Federal policy to root out discriminatory sources of those problems.

According to a November 1982 study by the U.S. Civil Rights Commission,[1] Blacks, Hispanics, and women are more heavily represented in all categories of employment hardship than they are in the general population. These measures include unemployment, intermittent employment, involuntary part-time employment, marginal jobs, workers in poverty households, overqualification for the job held, and low pay. These disparities are present in all phases of the business cycle, and across the spectrum of industries and regions.

Not all of the disadvantaged position of these and other minority groups is due to discrimination that can be reached effectively under current statutes. But some is. Moreover, it is longstanding Federal policy to reduce such discrimination. The need for the Federal Government to run efficient, adequately staffed, and effective anti-discrimination enforcement efforts is clear. The Justice Department, Office of Federal Contract Compliance, and Equal Employment Opportunity Commission should reaffirm a strong commitment to Title VII of the Civil Rights Act of 1964 and other job anti-discrimination measures.

EDUCATION AND SCIENCE

Recommendation No. 22

Education at all levels must be improved. Federal funds should be provided to raise the technical level of primary, secondary, and higher education, and to assure more equal educational opportunity across all regions, and for the disadvantaged.

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[1] "Unemployment and Underemployment Among Blacks, Hispanics and Women," U.S. Civil Rights Commission, November 1982.

The growth and competitiveness of the United States economy over the long run will depend in large part on the quality and level of education of the American work force. The present system of education in the United States has not produced the necessary numbers of workers with high levels of skills in math, science, and analytical ability. But that problem can be solved only in conjunction with a general program of improvement in our system of education.

The Federal Government has an important role to play in education. It is Federal resources which make possible a narrowing in what would otherwise be vast differentials in educational resources per pupil across States, and in different communities within States. It is Federal resources which provide opportunities for the educationally disadvantaged to participate more fully in economic life. By providing for a more even distribution of educational opportunity, the Federal Government has made possible the creation of a much more broadly based skilled labor force than would otherwise be the case.

There is evidence, moreover, that Federal assistance to education is effective. For example, the basic test scores of students in large urban school districts receiving substantial Federal assistance have risen. So have the cognitive skills of socially and economically disadvantaged children who participate in Title I programs. So, clearly, have the handicapped and otherwise educationally disabled, whose participation in a normal curriculum has been made possible by Federal funds.

Under the Reagan Administration, funds to meet all of the objectives of national education policy, particularly with respect to the disadvantaged, the handicapped, and to general educational resources in lower income states and communities, have been cut. The fiscal year 1983 budget for elementary and secondary education, for example, was $4.4 billion, which was $2 billion less than would have been required to maintain programs at their fiscal year 1982 levels. These sharp cuts reflect a reduced level of investment in the next generations of Americans, which could mean eventual productivity and competitiveness lower than can be achieved through strong and effective education.

One area of special concern is the declining quality of technical education in the United States today.

The Nation's potential for scientific and technological advancement depends directly on the quality of the scientific and technical education received by its students and on the numbers of students who enter these fields. In the area of mathematics, science, foreign languages, and technology education, we are currently witnessing a decline in student achievement, a drop in the number of students studying advanced science and mathematics subjects, a shortage of teachers in these areas, and deficiences in the number of skilled technicians and high-level scientific personnel. This situation, if not addressed, threatens to compromise America's stature in the international marketplace, weaken our industrial base, and undermine our national defense.

There currently exists a shortage of qualified science and math teachers and of individuals willing to enter teaching careers in these subjects. Furthermore, a growing number of qualified math and science teachers are leaving their profession to pursue other careers. The principal reasons the large salary differential which exists between the teaching profession and others which demand the same mathematical or scientific education and skills. For new graduates in science and math, the average salary in teaching is between $9,000 and $10,000, whereas scientific and technical jobs in industry pay $18,000 to $30,000. In addition to salary differences, some may consider teaching of lower professional status than work in reserch organizations or industry.

Various means of educational assessment show that the Nation has experienced a 20-year erosion of math and science competence at the precollege level. To reverse the trend, rewards to teaching technical fields must be increased. Special undergraduate scholarship, graduate fellowship, and low-interest loan programs should be available to prospective teachers in math, science, and other fields with inadequate supplies of teachers. Loans and other forms of financial assistance could be forgiven if students pursue a career in teaching for a designated number of years.

In the area of foreign languages, the proportion of secondary students enrolling in courses dropped from one-fourth in the mid-1960's to 15 percent in the 1970's. Our educational system has not placed sufficient emphasis on the study of foreign languages, as reflected by steadily diminishing educational requirements in this field. We should encourage student exposure to the languages and cultures of other countries and expand opportunities for exchange programs and study abroad.

These trends suggest that the current generation of students will be ill-prepared to meet the challenges of an increasingly technologically oriented and competitive job market. The National Science Foundation notes that there is a manpower shortage at nearly every degree level and specialty in engineering and the computer sciences, as well as in certain physical and biological science fields. Furthermore, the Bureau of Labor Statistics estimates that between 1980 and 1990 the demand for computer-related occupations is expected to grow by as much as 75 percent—and increase of 600,000 jobs. If the United States intends to succeed in the international markets for high technology products, we must address these deficiencies in our national educational system.

A student's early exposure to, and familiarity with, computers and other technical equipment can serve to spark his interest in the fields of science and technology. At present, according to the National Center for Education Statistics, slightly over one-third of the Nation's public schools have at least one computer available for classroom use. But as part of any effort to broaden the use of computers in classrooms, schools must also have trained personnel to explain its processes and sufficient software to operate the programs.

In addition to proficiency in these technical subjects, deficiences in the basic skills of the disadvantaged must be remedied. Educational institutions must equip students with adequte literacy and numerical skills as well as some facility with computers, to assure that opportunities for skilled jobs will be open to all.

While it is only a small part of total spending on education, Federal funding is critical to the skill development of millions who will otherwise be left behind. Funding for programs serving the disadvantaged, the handicapped, and other special educational needs must be made cost effective and must be maintained.

Recommendation No. 23

Federal support for nondefense reserach and development, especially in universities, should be increased.

In constant dollars, nondefense research and develpment (R&D) spending in fiscal year 1983 will be 6 percent lower than in fiscal year 1982 and 20 percent lower than in fiscal year 1981. The largest relative cuts in R&D outlays for fiscal year 1983 occurred in the environmental protection area, the National Bureau of Standards, the Commerce Department, and the Bureau of Mines.

The President's budget provides an increase in overall funding for R&D. However, when military and civilian activities are separated, the budget shows a substantial increase for military R&D and a reduction for civilian R&D, in real terms. This is the same pattern that has prevailed since 1981. Among the agencies whose R&D funds have been reduced are the Department of Energy (except for military research), NASA, the Department of Agriculture, the Department of the Interior, the Department of Commerce, and the Environmental Protection Agency.

The Federal Government's role in the national R&D effort continues to diminish. Federal R&D in fiscal year 1983 will comprise about 45 percent of the total projected U.S. spending on R&D, down from some 55 percent during the previous decade. This smaller Federal commitment to nondefense R&D runs counter to trends abroad. And, by holding back the rate of industrial innovation, it will hurt productivity growth.

The trend is disturbing because of the implication for productivity and economic growth. While the linkages between R&D, productivity, and economic growth cannot be precisely described, few doubt that they are interrelated. Many economists believe that the Nation's technological progress has been slowed and our industrial competitiveness has suffered in part because of the Federal Government's inadequate support for industrial research.

Future productivity gains depend in part on the ability to develop less costly ways of producing goods and services. Small firms have been the most innovative—and the heaviest investors in R&D. Accelerating the improvement of technology will require expansion of basic and applied research, as well as better dissemination of the results. Centers that bring university and industry researchers together for joint projects are a valuable means of strengthening this process.

INDUSTRY AND INFRASTRUCTURE

Recommendation No. 24

Programs to support industry should be designed to take advantage of new opportunities while retaining our old, productive strengths. The key ingredients include:

An efficient, up-to-date, well maintained public infrastructure.

Necessary Federal support to workers for adjustment to new industry.

The United States is and will remain and industrial nation. The challenge will be to create the conditions for a revival and sustained growth of American industry that is competitive in world markets, and so makes possible a continued high standard of living for American workers.

Private sector industrial investment requires and adequate and well-maintained infrastructure. The condition or our infrastructure—our roads, bridges, water systems, ports, utilities, rails, and other physical support systems—is not adequate. And although the need for maintenance, repair, and rebuilding of these systems grows every year, real capital expenditures by State and local governments continue to decline.

With the passage of the Surface Transportation Assistance Act of 1982, Congress is attempting to reverse the decline in expenditure on one aspect of the national infrastructure: our highways. In so doing, Congress has acknowledged that such investment is a vital ingredient of future national productivity growth. Such recognition should lead to careful planning for any other programs of Federal support for infrastructure that may be developed. This Committee is contributing to this effort by coordinating studies conducted by the various States of their public investment requirements and financing capacity. Such studies will be published as they become available throughout 1983.

Adjustment assistance represents another important element of economic development and the transition to more modern, productive, and technology-intensive processes. Both the workers who are currently (or were recently) employed in contracting industries and the communities which are home to those industries should be considered as national assets. They can either be reemployed, or they can be neglected. Clearly, national economic development will be greater and our standard of living higher if the former course is chosen.

For workers, every effort should be made to provide a range of opportunities in an industrial transition. These should include training and relocation assistance.

For communities affected by plant closings, Congress should consider providing transitional assistance to maintain public services should a dramatic erosion of the tax base occur. Such assistance could make it possible for a community to remain an attractive site for new investment, which derelict communities are not and so preserve the underlying physical community—streets, homes, schools, utilities, services, and trades.

Finally, consideration should be given to the problem of assuring that adequate capital is available to the most important of our basic industries to make possible modernization, rationalization, and redevelopment on an internationally competitive basis. Any program to facilitate acquistion of capital for such purposes must also assure that the basic public objectives—jobs and competitive industry—are met. The problems of the rapidly growing emerging industries should also be considered, recognizing that one of the strongest markets for robots, semiconductors, and the services of computer-aided design and manufacture are in traditional manufacturing enterprise.

AGRICULTURE

Recommendation No. 25

Congress and the USDA must take steps to ensure that efforts to reduce excess U.S. production, such as the Payment-In-Kind program, are successful.

In sharp contrast to the tremendous growth and accomplishments of U.S. agriculture during the 1970's, net farm income for the last three years has been at record low levels. In real dollar terms, 1982 net farm income was ¼ the level of 10 years ago, and roughly equivalent of that realized by farmers in 1933. Only the livestock sector has escaped, as incomes were bolstered by low feed prices. Nationwide the value of farmland has plummeted. Agricultural exports have dropped. Farm bankruptcies are up. And the farmer's problems have rippled over into their communities and related industries. Perhaps the only bright news for farmers has been the virtual halt of farm production cost increases, which had risen more than 60 percent between 1975 and 1981. Nonetheless, there is strong evidence that the agricultural bubble, inflated during the 1970's, has burst.

Perhaps the most worrisome problem plaguing the agriculture sector today is the growing surplus of U.S. crops—wheat, soybeans, and especially corn. Currently, the United States has more than 150 MMT of stocks exceeding projected demand—almost 2½ times the ending stocks just two years ago, and enough to meet our domestic needs for almost an entire year. It is our greatest surplus in more than 20 years, and it has resulted from three straight years of bumper crops at a time when export sales have lagged. The massive surplus has led to the lowest grain prices in years, and a sharp increase in government support payments to farmers. The public cost of farm programs in 1982 will likely exceed $12 billion, compared to $5 billion 10 years ago. The immediate farm policy challenge is to rapidly reduce price-depressing surplus grain stocks. The quickest way to accomplish this goal is to produce less and sell more in 1983.

A similar situation applies to the beleaguered dairy industry. The USDA has indicated that under current policy declines in the huge dairy surpluses in 1983 are likely to be very small at best. Other methods to reduce these surpluses should be explored.

The general consensus is that the traditional supply-control measures to reduce surpluses, such as the voluntary land set-aside program, have not been totally successful. This fact, coupled with record high government farm program costs and a growing budget deficit, prompted the Administration to implement the Payment-In-Kind (PIK) program. Under this program, farmers can retire up to an additional 30 percent of their land (50 percent when combined with the initial land set-aside program) and, in lieu of planting, receive commodities from government-owned or controlled stocks. Farmers can also bid their entire land base out of production. By limiting production and shrinking the supply of reserves overhanging markets, PIK may yield firmer prices in 1984 and beyond. The PIK program could be more successful at reducing 1983 grain and cotton output than many believe, because the net returns associated with the program could be very attractive to farmers.

Congress and the USDA must do what is necessary to ensure that efforts to trim excess U.S. production, such as through the PIK program, are successful. We must also closely monitor production by other countries. Sharp reductions in U.S. production could be seen by our competitors as an opportunity to boost their production to gain a greater share of the export market. Expanded production by non-U.S. grain suppliers, it must be cautioned, could easily offset U.S. production control efforts, contributing to yet further declines in world agricultural prices.

Recommendation No. 26

Congress and the Administration must increase efforts to expand farm exports.

Agricultural exports, once readily siphoning off excess U.S. production, have dropped due to the worldwide recession, the strengthened U.S. dollar, aggressive market expansion of other countries, and reduced U.S. purchases by the Soviet Union. After several straight record years, the dollar value of agricultural exports has dropped for the first time since the last global recession of 1975.

We must recognize the recent internationalization of the U.S. farm sector. Twenty years ago, we produced almost entirely for the domestic market, isolated from external changes. Today one out of every three bushels of U.S. grain is produced for export, and our farm sector is highly sensitive to supply and demand fluctuations in other countries, variations in currency exchange rates, and changes in foreign trade and agricultural policies. We must recognize this reality and meet the present challenge head on by developing an aggressive farm program of export promotion: expanding and improving our export credit and market development, meeting our competitors' export subsidies with price subsidies of our own, negotating reductions in protectionist barriers to our products, developing future markets through an expanded food aid program, negotiating long-term supply-purchase agreements, revising aspects of our farm programs that price our goods out of the world market, and guaranteeing that contracts to buy U.S. agricultural goods will not be cancelled for political reasons.

Recent promising Administration actions have been expanding the USDA "blended" credit program and negotiating the recent wheat-flour sale to Egypt. An additional $250 million in direct interest-free export credit will be blended with at least $1 billion in export credit guarantees to produce interest rates below commercial levels. The earlier blended credit program resulted in $500 million in additional U.S. export sales for an outlay of government funds of $100 million. The 1 MMT wheat-flour sale to Egypt negotiated by the USDA was made in direct response to European Economic Community export trade subsidies.

Ending the financial crisis in agriculture will require aggressive efforts to boost farm prices to profitable levels. Surplus stocks must be reduced and export sales increased. While this process occurs, farm credit programs must remain flexible enough to see farmers through this period of extremely low incomes and negative cash flows. Farm lending agencies, such as the Farmers Home Administration and the Farm Credit Administration, must be willing to defer loan payments on a case-by-case basis until farm incomes improve.

Indications are that 1983 will be neither the best of times nor the worst of times for U.S. farmers. Nominal total farm net income will likely be up only marginally in 1983. Recent dramatic and historic declines in farm operator equity, in combination with three, and likely four, consecutive years of poor income returns foretell major adjustments for the agricultural sector. In 1982, the asset base of U.S. agriculture was approximately $1 trillion. This investment yielded but $20 billion of net income, for a rate of return of only 2 percent. The modest economic recovery predicted by the Administration, followed perhaps years later by a modest world economic recovery, while necessary, will not be sufficient to restore prosperity to U.S. farmers. Clearly, the real economic challenge to U.S. agriculture lies ahead.

ENERGY

Recommendation No. 27

Incentives to conserve energy, to promote production of cost-efficient fossil fuels in the United States, to further reduce unreliable energy imports, and for research in renewable energy should remain high national priorities.

Energy use in 1982 fell for the third year in a row. Domestic energy consumption from all sources of energy, including petroleum, natural gas, coal, and electricity, declined at a preliminary rate of 3.4 percent compared to 1981. Energy use in 1982 was off almost 10 percent from the peak of 78.9 quadrillion BTU's (quads) consumed in 1979. The decline occured most heavily in natural gas with demand off 6 percent nationally, over double the rate of decline experienced for coal. This decline was concentrated heavily in the industrial sector where gas usage declined a very sharp 35 percent through September.

With only limited natural gas storage capacity, the decline in consumption was matched by a 7.4 percent decline in production through September. Modest increases in domestic petroleum production and a 6.4 percent rise in coal output offset declining gas output and yielded a slight 0.6 percent rise in overall domestic energy production last year through September compared to 1981.

Two notable trends emerged in 1981. First, production of hydroelectric power reversed its three-year decline and rose by close to 17 percent in 1982, compared to the first nine months of 1981. This reflected the boom in small-scale hydro projects intended to serve a broad cross-section of manufacturing facilities. Second, imports plunged in 1982 to 5 million barrels daily through September from 6 million barrels daily during 1981, and almost 7 million barrels per day in 1980. Altogether, petroleum imports over the first nine months of 1982 fell 16.6 percent below 1981 and were off a sharp 43 percent from the peak attained in 1977.

The decline in oil imports coupled with world oil price stability cut the U.S. foreign oil bill some 20 percent below the 1981 total of

$81.3 billion. That price stability should continue throughout 1983 in light of continued softness in world oil markets and present difficulties OPEC is having with its pricing policies. Barring further armed conflicts in the Middle East or elsewhere, foreign petroleum supplies will be abundant in 1983 with importers able to bargain effectively for stable or even lower prices.

But, while the oil glut may be with us for another year, it is not likely to be a permanent phenomenon.

The recent weak market, particularly for oil and natural gas, has sent exploration activities tumbling. This may expose the United States to needless supply vulnerability in the future. The number of crews engaged in seismic exploration plunged more than 13 percent in 1982, largely at on-shore sites. Because of its longer lead time, off-shore exploration activities did not begin to decline last year until July. Exploration rigs were stacked all across the Southwest, West, and Mountain states in 1982 as the number of rotary rigs in operation fell by 30 percent compared to 1981.

The Administration has reduced Federal outlays for energy conservation activities in the past two years. A focus on conservation has been maintained, however, in Federal tax policy and through incentives offered by a large number of states for building insulation, hydroelectric, and unconventional energy production. The Nation continues to improve the efficiency with which it utilizes energy. Efforts to improve conservation and alternate energy sources should be resume even though the energy crisis remains in remission.

STATISTICS FOR ECONOMIC ANALYSIS

Recommendation No. 28

The budget for economic statistics should restore adequate funding for crucial economic data.

A full review of Fiscal Year 1984 funding for GNP source data should be undertaken.

High quality Federal statistical programs are crucial to sound economic analysis and decision-making. The United States, with its strong reputation for expertise in statistical matters, had traditionally made maintaining these information sources a top priority. Recently, however, budget cuts at statistical agencies, coupled with the weakening of the interagency program coordination mechanism, have led to doubts about the government's continued capability to produce economic data meeting its traditional high standards of accuracy, timeliness, and completeness.

Budget cuts during the past few years have had a widespread effect on statistical programs. A staff study released by the Joint Economic Committee last year identified several high-priority statistical areas for which restoration of funds was desirable.[2]

Unfortunately many areas of the statistical program continue to suffer from ill-advised budget cuts. The employment and wage data programs at the Bureau of Labor Statistics, for example, have been cut so much that valuable, long-standing data series have had to be eliminated and research abandoned. The revision of the Consumer Price Index has also fallen behind schedule.

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[2] "Statistics for Economic Analysis: 1983 Budget Requirements," a study prepared for the use of the Joint Economic Committee, July 19, 1982.

While the importance of accurate GNP accounts is widely recognized, general budget stringency and organizational disarray in the statistical program have led to erosion in the completeness and timeliness of the source data for the GNP. Improving the quality of the GNP accounts demands priority attention. The Administration should provide Congress with an analysis of proposed budget changes having consequences for the GNP accounts and also with a multi-year plan for investing in the improvement of these accounts. This analysis should be made available to Congress in time to be useful in final decision-making on the 1984 budget.

COOPERATION AND A COMMON PURPOSE

Recommendation No. 29

Greater cooperation should be fostered among the institutions of government, business, and labor toward the common objective of higher productivity, international competitiveness, and a higher domestic standard of living.

The achievement of sustained noninflationary growth requires institutional changes which foster consensus in decision-making, cooperation on the job, and a sense of shared purpose among government, business, and labor. The relationships among these groups at present are unnecessarily adversarial. There is too much focus on short-term objectives, and there is inadequate consultation and coordination. Institutional rigidities, distrust, and the lack of cooperative spirit impede economic performance, both in current production and in the design and development of new products and processes.

A general commitment to greater cooperation and to the development of a common purpose has many aspects.

Labor-management relations must be improved. While there is no single blueprint for these activities, models exist: promising joint initiatives have occurred in plants, industries, and local communities around the country.

> At the plant level, labor and management have participated in quality of work life programs, quality circles, and other innovative approaches to problem-solving and workplace decision-making. Joint committees have tackled problems like absenteeism and turnover, bottlenecks in the production process, and changes in technology and skill requirements. They have brought about higher productivity, greater job satisfaction, and better labor-management relations.
>
> Cooperative labor-management efforts have helped the retail food, railroad, and airline industries cope with regulatory problems and improve competitiveness. In the telecommunications industry, there are joint committees which focus on broadening worker participation in decision-making and addressing problems that have tended to dehumanize work.
>
> Local communities have formed committees of major employers and unions, often to reduce strike activity and promote economic development. A leading example is Jamestown, New York, which has had a successful communitywide committee

> for nearly 10 years. Plagued with massive unemployment and a reputation for hostile labor-management relations, Jamestown organized a network of cooperative activities in local plants, special skill development programs, and other efforts to attract new firms and expand existing ones.
>
> Since the mid-1970's, a labor-management committee in Evansville, Indiana, has similarly worked to foster the growth of local industry. A relatively new committee in Philadelphia is focusing on the problems of displaced workers. There are currently initiatives in about 30 communities, half a dozen industries, and hundreds of individual plants—including small business and giant corporations. With proper encouragement, there could be many more.

In the Labor-Management Cooperation Act of 1978, Congress authorized the Federal Mediation and Conciliation Service (FMCS) to provide modest grants and technical assistance to labor-management committees established voluntarily on a plant, community, or industry-wide basis. Help from a neutral source like this agency can be critical in the initial stages of labor-management activity, and many of the existing efforts could never have started without Federal support.

Funding for the program has never been close to the $10 million authorized. The current level is $500,000 a year, enough for six grants.

Government-business-labor relations need fundamental reform. The government should encourage active consultation among all three parties.

In recent years, we have gained valuable experience in forgoing partnerships among business, labor, and government. This experience suggests that, through sustained effort and a broad commitment to cooperative endeavor, problems can be solved. For example, state and local governments, the United Automobile Workers, the Federal Government, and leading financial institutions came together with the leadership of the Chysler Corporation and struck a bargain which has permitted that corporation to survive despite bleak conditions in the automobile market. Similarly, the Steel Tripartite Advisory Committee, initiated by the AFL-CIO, the Carter Administration, and our leading steel companies, offered promise until the effort was abandoned in 1981. The advisory panel would provide a general-purpose institutional setting within which such efforts can be renewed.

Government, finally, must improve its own process of decision-making and intragovernment consensus-building. One key example is the current lack of coordination between the development of fiscal policy in the Executive branch and decision-making on monetary policy at the Federal Reserve. We find it difficult to have confidence in the compatibility of monetary and fiscal policies when cooperation is lacking. The President and the Federal Reserve Chairman should meet regularly and coordinate their activities closely. Ultimately, as discussed earlier in this Report, Congress must ensure that monetary and fiscal policies are coordinated and working toward a common objective.

ADDITIONAL VIEWS

ADDITIONAL VIEWS OF SENATOR EDWARD M. KENNEDY

Vice Chairman Hamilton, our Committee colleagues, and the staff deserve and have my admiration and appreciation for their hard and important work in fashioning this Report which makes a compelling argument against the continuation of our current economic path; and, even more important, charts a responsible and achievable alternative. The economic agenda set forth in this document is one rooted in the twin visions of economic growth and economic equity. It underscores the fundamental importance of full employment and balanced growth, while recognizing that our long-run economic health depends upon a restoration of fiscal responsibility and stable prices. It does not shrink from the tough decisions we must make about spending priorities, and it emphasizes that we must act forthrightly to ensure that the victims of today's devastating recession have our help now. I am proud to join with my colleagues in forwarding our recommendations to the House and Senate.

Our Report correctly emphasizes that a restoration of steady significant growth is our most important priority. However, I believe we must also acknowledge that growth alone will not be sufficient. Our economy also faces massive and fundamental structural problems which must be squarely addressed.

The international economic environment has changed markedly during the past decade. Rapid development and impressive productivity growth by our trading partners have created a new competitive environment which we cannot ignore.

The steady shift from manufacturing to services has left millions of workers and hundreds of communities with crucial adjustment problems which cannot be wished away.

Rapid, often dazzling, technological change poses difficult new problems for both goods-producing and service industries.

And the confluence of these changes has created an awareness of the central role that new forms of cooperation among business, labor, and government must play if we are to meet the challenges which lie ahead.

I believe that these problems require that we look beyond the macro policy tools which we must employ to restore growth, and consider what additional steps must be taken to sustain it.

At a minimum, these new tools—often now referred to as industrial policy—must include:

> A capacity to ensure coordination among the numerous—tax, trade, education and training, and infrastructure development—policies now utilized by government at all levels.
>
> A capacity to build and sustain cooperative relationships among all of the participants in the economic equation.

A capacity to target investment on those strategic—both basic and developing—industries that are fundamental to our future.

A capacity to develop long-range economic strategies which ensure (1) continued international competitiveness, and (2) that the fruits of economic strength will redound to the benefit of all Americans.

During the coming year, we must address these fundamental needs or run the very serious risk of seeing the benefits of the growth policy we have suggested dissipated. I look forward to joining with Vice Chairman Hamilton and our colleagues in that effort.

ADDITIONAL VIEWS OF REPRESENTATIVE AUGUSTUS F. HAWKINS

The February 1983 Economic Report of the President violates the statutory mandates of the Employment Act of 1946, as amended by the Full Employment and Balanced Growth Act of 1978.

The President is required to set goals and recommend policies designed to reduce unemployment to 4 percent and inflation to 3 percent by the end of 1987. The Full Employment and Balanced Growth Act specifically obligated the President to substitute meaningful programs and policies to achieve these defined objectives, in place of "forecasts," i.e., saying what is likely to happen if current policies continue.

The Report of the President forecasts a 7.3 percent unemployment rate for 1987, a 4.5 percent inflation rate, and makes no alternative recommendations as to how to achieve the statutory requirement of 4 percent unemployment and 3 percent inflation.

The President's Report unlawfully supports the trade-off theory of keeping unemployment unnecessarily high so that inflation can be reduced. This is in direct violation of Section 104 of the Full Employment and Balanced Growth Act which states, ". . . policies and programs for reducing the rate of inflation shall be designated so as not to impede achievement of the goals and timetables . . . for the reduction of unemployment." In addition, it is in direct violation of Section 105, which states, "In choosing means to achieve the goal for the reduction of unemployment and choosing means to achieve the goal of reasonable price stability, those means which are mutually reinforcing shall be used . . ."

Distinguishing the difference between current policies as described in the President's Report and those we should be following as alternatives is the first responsibility of the Joint Economic Committee in its Report on the President's Economic Report. The second responsibility is to offer a workable alternative to set us back on the right track.

While I commend the Vice Chairman, and I am in general agreement with the alternative program recommended in this Report, I believe the Full Employment and Balanced Growth Act embodies a more aggressive and comprehensive plan of remedies and appropriate alternatives which should be followed because it will more quickly increase employment and production, and attain the goals of full employment and price stability within the statutory timetable.

First, we should set economic goals on both an annual basis, as well as on a five-year basis, and then specify the policies and programs we must implement in order to reach those goals. As we go along, year by year, we will be able to measure our progress in achieving the reduction of unemployment, and if we are not succeeding in reducing joblessness fast enough to meet the mandatory goals, then we can make mid-course corrections so that the goals can be reached.

The Full Employment and Balanced Growth Act requires monetary and fiscal policy formulation to support full employment and full production. Current economic policy decision-making, as evidenced by the grossly inadequate Report of the President, is made on an ad-hoc basis, and will again result in wasteful, duplicitous, and mismanaged government policy.

Monetary policy is overly restrictive, stunting economic growth and creating excessive levels of interest rates. Congress has the authority to direct the Federal Reserve Board to comply with the current requirements of law, and the President, through the Economic Report, can also tell the Federal Reserve Board to coordinate its policies, as other governmental entities are required to do.

Additional alternatives to the Federal Reserve Board's policies can be achieved through a tightening of its reporting provisions in the Full Employment and Balanced Growth Act, congressional action mandating lower interest rates to levels that are consistent with a GNP rate that will effectively begin to reduce unemployment, and amending the Federal Reserve Act to make the board more accountable to the President, the Congress, and thus the American people.

Fiscal policies are currently misdirected, suppressing ultimate demand and regressively redistributing income. As I stated in my footnote to Recommendation No. 1, too much attention is being put on reducing deficits as a means for sustaining economic growth, as opposed to being an end result of alternative programs and policies. Alternatives to this policy lie in changing the structure of our tax system, and in selectively increasing and targeting Federal budget outlays to achieve employment creation and a more balanced attention to national priorities in order to achieve sustained economic growth.

Tax indexing should be abandoned. While the idea may sound good on its face, the net effect of it in practice would be very regressive. Tax law should be revised to reduce or eliminate tax preferences that serve as incentives for speculation or other unproductive investment. Tax credit programs should focus on providing incentives for employment and self-sufficiency. For the outyears, loopholes should be closed.

Federal Budget spending programs should be viewed as tools for achieving sustained growth and as investments which will end up paying for themselves as economic recovery and overall growth take hold. Increased Federal spending, targeted to the labor force groups, sectors of the economy, and regions experiencing economic difficulties, is the most powerful tool we have in stimulating the economy and balancing priorities. In addition, it can be the most effective anti-inflation program we have. Stable, balanced growth is a key to price stability. Full employment and production prevents shortages, which result in higher prices.

The Full Employment and Balanced Growth Act recognizes that monetary and fiscal policies alone cannot achieve the quantitative goals mandated by law. Structural programs must be used to supplement macroeconomic policy. While policies to promote aggregate demand for goods and services provide overall stimulus necessary to reduce unemployment and increase production, it only goes so far, and disparities and inequities remain among certain labor force groups, industrial sectors, and geographic areas.

Structural programs are necessary to close the gap among these groups and sectors, so that all those able, willing, and seeking work have the opportunity for employment at fair rates of compensation. Targeting structural programs will also enable achievement of full employment simultaneously with price stability.

Thus, the Full Employment and Balanced Growth Act should be properly implemented. The preeminent goal guiding economic policy should be full employment: the full utilization of our material and human resources. When balanced in its approach, a full employment and full production alternative would do more than anything else to improve productivity and reduce inflationary pressures. When joined with structural programs which provide jobs skills, education and opportunities, and targeted investment and job creation in the sectors of the economy and geographic areas which are underutilized or where shortages exist, the attainment of full employment with price stability will be a reality.

CURRENT SERVICES BUDGET ESTIMATES

Current Services Budget Estimates [1]

The Congressional Budget Act of 1974 (Section 605) requires that the President submit a current services budget to Congress. This budget notes the level of outlays and budget authority "for the ensuing fiscal year if all programs and activities were carried on during such ensuing fiscal year at the same level as the fiscal year in progress and without policy changes in such programs and activities." Such benchmark estimates and the corresponding current services receipts estimates are to be accompanied by "the economic and programmatic assumptions underlying the estimated outlays and proposed budget authority, such as the rate of inflation, the rate of real economic growth, the unemployment rate, program case loads, and pay increases." The current services budget plays a vital role in expediting efforts of congressional committees and the Administration to develop and evaluate timely and credible policy alternatives. Current services outlays by function and receipts by source for 1984 are compared with the corresponding 1982, estimated 1983, and proposed 1984 amounts in Table III. The deficit, off-budget outlays, and total budget authority are also shown.

TABLE III.—RECEIPTS BY SOURCE AND OUTLAYS BY FUNCTION, FISCAL YEAR 1982, ADMINISTRATION'S CURRENT SERVICES BASIS FOR FISCAL YEARS 1982–83, AND PROPOSAL FOR FISCAL YEAR 1984

[In billions of dollars]

	1982 actual	1983 current services	1984		
			Current services	Administration proposal	Difference from current services
Receipts:					
Individual income taxes	$297.7	$285.2	$295.8	$295.6	−$0.2
Corporation income taxes	49.2	35.3	51.9	51.8	−0.1
Social insurance taxes and contributions	201.5	210.3	231.7	242.9	11.2
Excise taxes	36.3	37.3	40.4	40.4	0.0
Other	33.0	29.4	29.0	29.1	0.1
Total receipts	617.8	597.5	648.8	659.7	10.9
Outlays:					
National defense [1]	187.4	214.6	253.7	245.3	−8.4
International affairs	10.0	11.7	12.8	13.2	0.4
General science, space, and technology	7.1	7.8	8.1	8.2	0.2
Energy	4.7	4.6	4.1	3.3	−0.7
Natural resources and environment	12.9	12.0	11.2	9.8	−1.4
Agriculture	14.9	21.7	15.3	12.1	−3.2
Commerce and housing credit	3.9	2.0	2.1	0.4	−1.6
Transportation	20.6	21.9	26.1	25.1	−0.9
Community and regional development	7.2	7.4	7.2	7.0	−0.2

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[1] All years referred to are fiscal years.

TABLE III.—RECEIPTS BY SOURCE AND OUTLAYS BY FUNCTION, FISCAL YEAR 1982, ADMINISTRATION'S CURRENT SERVICES BASIS FOR FISCAL YEARS 1982–83, AND PROPOSAL FOR FISCAL YEAR 1984—Continued

[In billions of dollars]

	1982 actual	1983 current services	1984		
			Current services	Administration proposal	Difference from current services
Education, training, employment, and social services	26.3	26.8	27.1	25.3	−1.8
Health	74.0	82.3	92.9	90.6	−2.3
Income security	248.3	282.8	289.7	282.4	−7.3
Veterans benefits and services	24.0	24.5	26.1	25.7	−0.4
Administration of justice	4.7	5.3	5.5	5.5	0.0
General Government	4.7	5.9	5.9	6.0	0.1
General purpose fiscal assistance	6.4	6.4	7.2	7.0	−0.2
Net interest	84.7	89.0	105.2	103.2	−2.0
Allowances	0.0	0.0	1.9	0.9	−1.0
Undistributed offsetting receipts	−13.2	−20.4	−21.6	−22.8	−1.1
Total outlays	728.4	806.1	880.3	848.5	−31.8
Deficit (−)	−110.6	−208.5	−231.5	−188.8	42.7
Off-Budget Outlays	17.3	16.9	17.1	14.0	−3.0
Deficit (−) Including Off-Budget Outlays	−127.9	−225.4	−248.5	−202.8	45.7
Budget Authority	779.9	828.4	954.8	900.1	−54.7

[1] See Table IV and discussion of estimated current services outlays for national defense in the text.

Sources: Office of Management and Budget, "Budget of the United States Government, Fiscal Year 1984," p. 9–4, and "Special Analysis A (Current Services Estimates)," pp. A–4, A–6, A–7, A–11.

Since the 1981 budget, the economic assumptions utilized in the current services estimates and other components of the President's budget have been identical. This practice was continued in preparation of the 1984 budget documents as well. This uniformity resulted from repeated recommendations by this Committee that economic assumptions for each program be consistent. In 1981 and 1982, the Committee recommended modification of Section 605 of the Congressional Budget Act to require submission by the President of a current services budget by January 31 of each year, with the Joint Economic Committee evaluation to follow by March 1. This change would make the law consistent with the present satisfactory practice. That Act now requires submission by the President of current services budget estimates on or before November 10 of each year, and the Committee's evaluation of such budget estimates must be submitted to both Budget Committees by December 31. Compliance with these deadlines has typically not occurred because it would reduce the usefulness of the evaluation which would be based on assumptions not necessarily adopted for the ensuing budget. Each year, it has been necessary to extend the deadlines on a one-year basis because the proposed modification in the Budget Act has not been made, and the Committee again urges that this step be taken.

In previous years, this Committee has called for more detailed current services estimates for a five-year period, to facilitate longer run policy formulation. Last year the Administration provided projections of outlays on a "current services baseline with adequate defense" basis for five fiscal years. This presentation combined two very important but very different concepts—current services and an "adequate defense." The basic rationale for current services budget is that it is intended to provide objective estimates of spending in the absence of policy changes. By combining it with the much more subjective (though important) concept of an "adequate defense," the estimates lose their meaning and, in fact, they create confusion. Also, last year no details were provided for the outyears on budget categories other than defense.

A major improvement has been made in the current services budget this year in that five-year budget estimates have been made of total budget authority, receipts, outlays, deficits, and off-budget outlays. Also differences between current services and proposed outlays by function have been presented for 1984–1988. These functional estimates would be somewhat more useful if the level of current services outlays by function were shown as well as the differences between current services outlays and the Administration's proposals. In this year's budget, current services outlays by function must be calculated by adding these differences to the proposed outlays.

The major shortcoming of the 1984 current services budget is its treatment of budget authority and outlays for defense. In an acknowledged "major exception" to normal practice, the Administration indicates that the estimated military budget authority for 1984 and outlays for 1984–1987 are not intended to represent costs "if all programs and activities were carried on . . . at the same level as the fiscal year in progress and without policy changes in such programs and activities," the definition of current services in the Budget Act. Rather, the 1984–1987 estimates are "those presented by the Administration and used by Congress in last year's budget deliberations," and the 1988 estimates "were developed consistent with this baseline." This baseline is "believed to be the most useful one for measuring the effects of policy changes in the defense area." [2] It is not specified in the Special Analysis whether the Administration or the Congress finds this baseline "the most useful one," nor, if the latter, how such a determination was made. And there is no indication why similar baselines might not be "the most useful" as in other areas as well.

The basis for current services defense estimates has major implications. As shown in Table IV, over the 1983–1988 period, the Administration's proposed outlays for defense ($1,808.3 billion) represent a $46.9 billion reduction from the Administration's current services estimates, but increases ranging from $74.0 billion to $353.3 billion in comparison with the other four baselines listed.[3] These differences between proposed outlays and various current services measures vary by more than $400 billion over this period. Similarly, as shown in Table V, over the 1983–1988 period, the Administration's proposed budget authority for defense ($2,050.5 billion) represents a $54.4 billion reduction from the Administration's current services estimates, but increases ranging from $84.9 billion to $389.4 billion in comparison with the other four baselines listed.

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[2] Office of Management and Budget, "Special Analyses, Budget of the United States Government, Fiscal Year 1984," p. A-3.

[3] These comparisons do not take into account any differences between the economic forecasts of the Administration and the Congressional Budget Office. Such differences appear to be relatively small in comparsion with the magnitudes involved.

TABLE IV—OUTLAYS FOR NATIONAL DEFENSE: ADMINISTRATION PROPOSALS AND VARIOUS BASELINES FISCAL YEARS 1983–88

[In billions of dollars]

Fiscal year	Baseline					Administration proposal	Difference between administration proposal and baseline				
	(1)	(2)	(3)	(4)	(5)		(1)	(2)	(3)	(4)	(5)
1983	214.8	213.5	213.5	213.5	214.6	214.8	0.0	1.3	1.3	1.3	0.2
1984	222.4	234.0	236.8	242.1	253.7	245.3	22.9	11.3	8.5	3.2	−8.4
1985	236.0	251.0	259.6	277.7	293.4	285.3	49.3	34.3	25.7	7.6	−8.1
1986	248.1	267.0	280.5	310.0	332.2	323.0	74.9	56.0	42.5	13.0	−9.2
1987	260.4	285.0	300.0	333.0	364.7	354.3	93.9	69.3	54.3	21.3	−10.4
1988	273.3	303.0	320.7	358.0	396.6	385.6	112.3	82.6	64.9	27.6	−11.0
Total	1,455.0	1,553.5	1,611.1	1,734.3	1,855.2	1,808.3	353.3	254.8	197.2	74.0	−46.9

Sources:

(1) No real growth, as derived from OMB data contained in Congressional Budget Office "An Analysis of the President's Budgetary Proposals for Fiscal Year 1984." Feb. 1983, p. 54

(2) CBO's "no real growth" path, from CBO's "Baseline Budget Projections for Fiscal Year 1984–88." Feb. 3, 1983, p. 45.

(3) CBO's "programmatic component of baseline," same source as (2), p. 100.

(4) CBO's baseline, same source as (2), p. 100.

(5) Administration's current services budget, from Office of Management and Budget, "Special Analyses, Budget of the United States Government, Fiscal Year 1984," pp. A–7, A–16.

Administration Proposal: Office of Management and Budget, "Budget of the United States Government, Fiscal Year 1984," p. 9–5.

Note: Adjustments have not been made in (2)–(4) for any differences between the CBO and Administration economic forecasts, which do not have major impacts on estimated defense outlays.

TABLE V.—BUDGET AUTHORITY FOR NATIONAL DEFENSE: ADMINISTRATION PROPOSALS AND VARIOUS BASELINES, FISCAL YEARS 1983–88

[In billions of dollars]

Fiscal year	Baseline					Administration proposal	Difference between administration proposal and baseline				
	(1)	(2)	(3)	(4)	(5)		(1)	(2)	(3)	(4)	(5)
1983	245.5	243.9	243.9	243.9	244.5	245.5	0.0	1.6	1.6	1.6	1.0
1984	254.5	258.0	267.5	278.3	291.8	280.5	26.0	22.5	13.0	2.2	−11.3
1985	269.3	273.0	286.7	322.4	339.4	330.0	60.7	57.0	43.3	7.6	−9.4
1986	283.0	288.0	304.1	350.0	375.4	364.8	81.8	76.8	60.7	14.8	−10.6
1987	297.0	304.0	322.0	373.0	408.7	397.0	100.0	93.0	75.0	24.0	−11.7
1988	311.8	322.0	352.7	398.0	445.1	432.7	120.9	110.7	80.0	34.7	−12.4
Total	1,661.1	1,688.9	1,776.9	1,965.6	2,104.9	2,050.5	389.4	361.6	273.6	84.9	−54.4

Sources:

(1)–(4) As in Table IV.

(5) As for (1). p. 80,

Administration Proposal: As for (1).

Note: Adjustments have not been made in (2)–(4) for any differences between the CBO and Administration economic forecasts, which do not have major impacts in estimated defense budget authority.

These difference between proposed budget authority and various current services measures of budget authority vary by more than $400 billion over this period. Percentage increases in defense outlays and budget authority using the various measures are compared in Table VI for 1983–1988.

TABLE VI.—AVERAGE ANNUAL INCREASES IN VARIOUS MEASURES OF DEFENSE SPENDING, FISCAL YEARS 1983-88

[In percent]

Measure	Average annual percentage increase, fiscal years 1983-88	
	Outlays	Budget authority
Estimates in current dollars:		
Baseline (1)	4.9	4.9
Baseline (2)	7.3	5.7
Baseline (3)	8.5	7.7
Baseline (4)	10.9	10.3
Baseline (5)	13.1	12.7
Administration proposal	12.4	12.0
Estimates in constant dollars:[1]		
Baseline (1)	0.0	0.0
Baseline (2)	2.2	0.8
Baseline (3)	3.4	2.6
Baseline (4)	5.7	5.1
Baseline (5)	7.8	7.5
Administration proposal	7.1	6.8

[1] In comparison with baseline (1).

Sources: Calculated from data in Tables III and IV.

The Congressional Budget Office rejected its "no real growth" estimates as its baseline. The CBO "no real growth" path over the 1984-1988 period implies increases in defense outlays averaging 7.3 percent per year and increases in defense budget authority averaging 5.7 percent per year, well above OMB's implicit estimates, but CBO felt that funding at such levels "could require cancelation of some investment programs, rescheduling of others, and some force structure deactivation." [4] CBO's "no real growth" path probably does understate a realistic level of current services defense spending. But it is also clear that the Administration's current services defense budget significantly overstates the level of expenditures consistent with the definition of current services contained in the Budget Act. The most realistic benchmark appears to be baseline (3), CBO's "programmatic component of baseline."

In discussing the differences between the estimated current services and proposed budgets, the Administration cites savings in the defense area "due to lower inflation, the 1984 pay freeze, and various program economies." [5] The proposed pay freeze and program economies represent legitimate savings from current services spending. Lower inflation will help restrain defense outlays by an estimated $35 billion over the 1984-1988 period according to Administration estimates, but by definition these savings do not represent savings from current services, properly defined. The current services budget, as well as the proposed budget, should be reduced to take account of lower inflation, leaving the difference between the two unchanged.

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[4] Congressional Budget Office, "Baseline Budget Projections for Fiscal Years 1984-88," p. 46.

[5] Office of Management and Budget, "Special Analyses, Budget of the United States Government, Fiscal Year 1984," p. A-12.

In summary, in many areas, the current services budget has been improved by providing more detailed estimates of outlays by function and receipts by source over a five-year period. A five-year analysis of current services budget authority by function would also be useful. In the defense area, the Administration has inexplicably departed from the basic definitions of current services in the Budget Act. Current services defense estimates based on last year's budget proposals by the Administration are confusing and misleading. In the future, the analysis of the defense program should be based on a legitimate current services concept, not on the previous year's budget proposals.

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